

The planned additions to military forces do not, however, seem to require these substantial increases in real O&M. By 1987, the Administration plans to increase active-duty personnel by about 8 percent. Under this plan, the United States will have added only about 42 more ships (an increase of 8 percent) and 500 more aircraft (a 9 percent increase). An exception is the Army, which plans to add 3,735 more tanks (a 30 percent increase) to its inventories, of which 1,000 tanks will be assigned to prepositioned storage in Europe. CBO estimates that the additional O&M required to support these new forces at today's spending rates would add only about 5 percent to real O&M spending over the 1983-1987 period. (No program detail for 1988 was available at time of publication.)

Thus, it appears that much of the planned increase in O&M spending must be designed to improve the levels of readiness of existing forces. Readiness may have fallen in the 1970s, as the United States cut back on overall defense spending. Unfortunately, the Department of Defense has no aggregate measures of readiness that indicate how far it fell, nor quantifiable goals that suggest how much it needs to be increased.

This is not to say that the Congress should allow no growth in real O&M spending. New, more complex systems may require more O&M. Concern has been expressed about certain areas of readiness--for example, the level of spare parts necessary to support wartime surge rates in aircraft utilization. In a period of fiscal austerity, however, it may be reasonable to limit the rate of growth of O&M to less than the Administration targets.

Table II-4 illustrates the savings that would be possible if the rate of growth in O&M was reduced by one percentage point in each year, 1984-1988. (The Congress reduced the 1983 requested rate of real growth by approximately 6 percentage points.) Savings under this approach would be \$0.6 billion in 1984 and would total \$12.6 billion over the next five years.

A variety of changes in O&M would be required to achieve this slower rate of growth. Some changes in 1983 included accelerating the decommissioning of 22 ships, postponing some ship overhauls, reducing selected flying-hour programs, and lowering somewhat depot maintenance activity in the Air Force. These actions saved an estimated \$608 million in 1983. When additional reductions--such as foreign currency reevaluation and fuel repricing--are added, the total savings were about \$3.6 billion in 1983.

Other Approaches to Achieving Savings in Defense Spending

The targeted cost reduction strategies presented in this chapter have been concentrated in procurement accounts, where the primary buildup in

spending has taken place. There are many other areas in which efficiencies and savings might be achieved, though the details go beyond the limits of this chapter.

For example, closing or consolidating defense bases would reduce costs for personnel and for operations and maintenance, though savings are often consumed in the early years by the need to cushion local economic dislocation. A return to peacetime conscription could reduce costs, though probably only between \$1 billion and \$2 billion a year and then only if pay for new recruits was reduced. A more efficient defense procurement process might also cut costs, and in some degree this has been pursued by the Administration. ^{19/}

The Congress could also cut defense costs by repealing or modifying certain laws that raise costs. For example, the 1931 Davis-Bacon Act and more than 70 related federal statutes require that wages paid on most federal and federally assisted construction projects equal the prevailing wage in the local area. Critics of the act claim that procedures used for calculating Davis-Bacon rates raise wages paid on federal projects above those prevailing in the locality. Repeal or modification of Davis-Bacon, it is argued, might result in significant budget savings, especially in the three largest federal construction programs: military construction, Environmental Protection Agency construction grants, and ground transportation construction. DoD has claimed, for example, that military construction costs could be cut by 2 to 4 percent if the Davis-Bacon act was repealed, or if DoD was exempted from its provisions. Actual savings could well be more modest. Estimated savings from changing procedures for calculating prevailing wages are discussed in Chapter VII.

Substantial savings might also be achieved by small efficiencies throughout the Department of Defense, with its more than 5,000 installations and properties. This would be facilitated if the Congress worked with the department to modify the incentives facing defense managers; currently, managers who reduce costs may simply achieve a lower budget. Managers might be allowed to keep a portion of verified savings from management efficiencies to apply toward projects that they feel are important but are not funded. Similarly, they might be allowed to request money--above their budgets--to finance projects that quickly repay their

19. For a discussion of these issues, see Congressional Budget Office, Reducing the Federal Deficit: Strategies and Options (February 1982), especially pp. 51-54.

costs through savings from increased efficiency. This latter approach has already been tried but might be expanded.

CONCLUDING COMMENTS

The preceding discussion specified a number of reductions that might be made in order to bring the increasing level of defense spending down in 1984 and beyond. As noted at the outset of this chapter, the debate on national defense in the 98th Congress will proceed at two levels. Broadly, the Congress will determine the aggregate level of spending it chooses to devote to national defense. At a more detailed level, it must choose specific programs in which to make cuts.

Even if all the reductions outlined above were made, the defense budget would still grow at approximately the rate specified in last year's budget resolution. Should larger cuts be desired, a more radical departure from Administration defense plans would be necessary. For example, a no-real-growth option would be an extraordinarily difficult course to follow, necessitating cancellation of most major program initiatives launched by the department, unless defense readiness is to be sacrificed.

CHAPTER III. SOCIAL SECURITY

The Social Security system faces serious funding problems in the near future and potentially major financing difficulties over the long run. In addition, because its outlays now exceed its revenues, the system is also contributing to the unified budget deficit as a whole. ^{1/} The system's two cash benefit programs--Old Age and Survivors' Insurance (OASI) and Disability Insurance (DI)--account for over one-fifth of the federal budget, and more than two-fifths of all benefits for individuals. ^{2/} Both the current financing problems of the Social Security system, and the large share of the budget that it represents, will make some consideration of spending reductions and revenue increases necessary in this program within the coming year. The President's bipartisan National Commission on Social Security Reform recently recommended a set of measures to improve the financial condition of the trust funds, which is now under consideration by the Congress.

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1. The unified budget deficit for a given year equals total federal revenues received in that year from sources included in the budget, minus total federal budget outlays in that year. Social Security revenues and outlays are treated in the same manner as other revenues and outlays, and no special allowance is made for their trust fund status. Reserves, which represent unspent funds from past years, do not affect the current year's budget deficit, since they have already been taken into account as previous years' revenues. If Social Security were removed from the unified budget, its year-to-year surplus or deficit would no longer affect the unified budget deficit, although its impact on the total federal budget and on the economy would, of course, remain the same.
 2. This chapter concentrates on the outlays and revenues of the two cash benefit programs, so the term Social Security is used throughout to refer to the programs providing cash benefits to retired and disabled workers and their families and survivors. Issues relating to noncash benefits--that is, Medicare benefits, which are provided through Social Security's Hospital Insurance (HI) trust fund, and through the Supplementary Medical Insurance (SMI) program--are discussed in Chapter IV.

The Short-Term Financing Problem. The current financing problem is caused primarily by increases in benefit payments that have exceeded increases in payroll tax revenues, resulting in a continuing depletion of trust fund reserves. This situation has occurred because prices--and therefore, cost-of-living adjustments--have increased more rapidly than wages in recent years. As a consequence, the OASI trust fund, which provides benefits for retired workers and their dependents and survivors, will be unable to pay all benefits on time beginning in July 1983--despite having borrowed \$17.5 billion from the DI and Hospital Insurance (HI) trust funds. The latter two trust funds, which provide benefits for disabled workers and their families and hospitalization benefits under Medicare, have higher reserve levels than the OASI fund, but nonetheless the combined balances of all three trust funds will decline to less than one month's worth of benefits by January 1984. For the 1984-1988 period, the annual deficit in the OASDI funds is expected to average \$10.8 billion.

The Long-Term Financing Problem. In the longer run, Social Security must also reckon with the retirement of the post-World War II baby boom workers after 2010. The OASDI funds are projected to have a long-term deficit averaging approximately 13 percent of annual expenditures over the next 75 years, under the intermediate economic and demographic assumptions of the 1982 Social Security Trustees' Report. In general, proposals for changes to reduce this long-run deficit include a gradual phase-in period to allow individuals, employers, and private pension plans to adjust to the changes without severe dislocations. Because they would be phased in, however, such long-range changes--for example, lowering the level of initial benefits or raising the retirement age--would generally result in little or no savings in the short run. 3/

BUDGET HISTORY AND PROJECTIONS

Over the past three years, Social Security outlays grew by 50 percent, with roughly 80 percent of the growth resulting from annual benefit increases tied to the Consumer Price Index. Payroll tax revenues grew almost as rapidly--about 46 percent--but fell short of outlays in each year. As a result, the OASDI programs accounted for nearly \$9 billion of the annual federal deficit, on average, in the 1980-1982 period.

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3. For a more complete discussion of Social Security problems and options over the long run, see Congressional Budget Office, Financing Social Security: Issues and Options for the Long Run (November 1982).

The major reason why outlays have grown faster than revenues is that prices have risen faster than wages and salaries since 1979, and Social Security benefits are automatically adjusted, or indexed, to the rise in the Consumer Price Index, while payroll tax revenues increase with the growth of the taxable wage base. Moreover, high unemployment rates have adversely affected trust fund balances by decreasing the number of workers paying taxes, and they may also have increased outlays by inducing more people to retire early.

Although a moderate recovery is projected for the 1984-1988 period, OASDI outlays are expected to continue to exceed revenues in each of the next five years. This shortfall will occur in spite of the payroll tax increase already scheduled under current law. ^{4/} Some modifications in the program will be needed, therefore, in order to continue the timely payment of benefits.

Recent History, 1980-1982

Most of the benefit reductions legislated during 1980-1982 were directed at small, specific groups of beneficiaries, and therefore had little effect on overall OASDI outlays (that is, the combined outlays of both the OASI and DI trust funds). The major Social Security reduction included in the 1981 Reconciliation Act and subsequent legislation, for example, was the elimination of post-secondary students' benefits. This had a large impact on the beneficiaries affected, but in combination with several smaller changes, reduced the overall size of the Social Security cash benefit programs by only about 2 percent. ^{5/} This small reduction contrasts with the relatively large cuts in other entitlement programs, particularly means-tested programs. ^{6/}

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4. The Social Security Amendments of 1977 scheduled increases in OASDI tax rates for 1978, 1979, 1981, 1982, 1985, and 1990.
 5. The other major benefit cut enacted as part of the 1981 Reconciliation Act, the elimination of the minimum benefit, was later restored for those eligible for the benefit before January 1982 by the Social Security Amendments of 1981.
 6. An entitlement program is a program that provides benefits to all persons who meet certain eligibility criteria, and its outlays are determined by benefit levels and the number of qualifying applicants. Means-tested programs restrict eligibility to those whose incomes fall below specified levels; other requirements must often be met as well.

The Administration did not propose, and the Congress did not enact, any specific modifications in Social Security for 1983. Instead, both branches awaited the recommendations of the National Commission on Social Security Reform, which had been established by the President in December 1981. The Commission's final report, submitted to the President and the Congress in January 1983, contained a set of recommendations designed to alleviate the short-term Social Security funding problems. ^{7/} These are examined later in this chapter.

Current Situation

CBO estimates that combined OASDI expenditures will total \$171.4 billion in 1983, with OASI accounting for \$152.7 billion and DI for \$18.7 billion (see Table III-1). Income to the OASDI trust funds is estimated to be \$165.5 billion in 1983, with 90.7 percent of that total representing payroll tax receipts. Borrowing from the HI fund and interest income constitute most of the remaining income. Because outlays are expected to exceed revenues in 1983, the OASDI funds will contribute to the 1983 federal budget deficit.

Baseline Projections, 1984-1988

OASDI expenditures are projected to rise from \$171.4 billion in 1983 to \$183.5 billion in 1984 and \$236.8 billion in 1988. Current law OASI payments alone are expected to reach \$216.1 billion by 1988. OASDI income is projected to grow by about \$65 billion over the next five years and to reach \$230.1 billion in 1988. Thus, without change, Social Security revenues will fall short of outlays in each of the next five years.

Under CBO's current projections, the OASI fund would require about \$160 billion in additional resources over fiscal years 1983-1988 in order to maintain a 12 percent start-of-year fund balance over that period--the minimum reserve needed to avoid cash-flow problems during the year. ^{8/} If the OASI and DI funds are considered in combination, only about \$71 billion

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7. The Commission's recommendations for the short term are also estimated to reduce the 75-year deficit by about two-thirds. The Commission could not agree on measures to eliminate the remaining one-third of the projected long-run deficit.
 8. Since all cash benefits are paid on one day early in each month while payroll tax revenues are received continuously during the month, roughly 9 percent of annual calendar year outlays must be on hand at

TABLE III-1. CURRENT LAW PROJECTIONS OF SOCIAL SECURITY TRUST FUND
OUTLAYS, INCOMES, AND BALANCES (In billions of dollars)

	Actual		Estimated 1983	Baseline Projection				
	1980	1982		1984	1985	1986	1987	1988
Old Age and Survivors Insurance								
Total Outlays	103.2	137.9	152.7	164.4	176.5	189.1	201.8	216.1
Income <u>a/</u>	100.1	126.6	146.5	138.3	150.8	162.5	172.7	185.1
Year-End Balance	24.6	12.5	6.3	-19.8	-45.5	-72.1	-101.2	-132.1
Start-of-Year Balance as Percent of Outlays	26.8	17.3	8.2	3.9	-11.2	-24.1	-35.7	-46.8
Disability Insurance								
Total Outlays	15.3	18.0	18.7	19.1	19.2	19.4	20.0	20.8
Income <u>a/</u>	17.4	21.4	19.0	26.8	32.7	37.4	41.0	45.0
Year-End Balance	7.7	6.8	7.0	14.8	28.3	46.3	67.2	91.4
Start-of-Year Balance as Percent of Outlays	36.6	18.8	36.0	37.0	77.0	146.0	231.2	323.9
Combined OASI and DI								
Total Outlays	118.5	156.0	171.4	183.5	195.6	208.5	221.8	236.8
Income <u>a/</u>	117.4	148.0	165.5	165.0	183.4	199.9	213.7	230.1
Year-End Balance	32.2	19.3	13.4	-5.1	-17.3	-25.8	-34.0	-40.7
Start-of-Year Balance as Percent of Outlays	28.1	17.5	11.3	7.3	-2.6	-8.3	-11.6	-14.3
Combined OASI, DI, and Hospital Insurance								
Total Outlays	142.8	190.8	210.4	227.8	245.3	265.8	288.3	311.6
Income <u>a/</u>	142.8	185.6	193.4	209.3	232.0	255.1	272.9	293.0
Year-End Balance	46.7	40.1	23.2	4.7	-8.6	-19.4	-34.7	-53.3
Start-of-Year Balance as Percent of Outlays	32.7	23.8	19.1	10.2	1.9	-3.2	-6.7	-11.1

NOTE: Minus signs denote a deficit.

- a. Income to the trust funds is budget authority. It includes payroll tax receipts, interest on balances, and certain general fund transfers. Income in 1983 reflects interfund transfers as authorized under the Social Security Amendments of 1981. In order to illustrate better the operations of the trust funds under extended interfund or other types of borrowing or under tax rate reallocation, estimated interest payments owed by a trust fund when it shows a deficit are included as negative values in the income estimates of that trust fund.

in additional resources would be needed, since income received by the DI fund is expected to exceed its outlays, although its surplus would not entirely offset the OASI deficit.

A 12 percent start-of-year balance, however, provides no margin of safety for the trust funds, and could result in further financing problems if economic conditions prove to be only slightly worse than the CBO projects. In fact, Social Security is so sensitive to the performance of the economy that the National Commission on Social Security Reform decided that \$150 billion to \$200 billion in additional reserves would be necessary over the calendar year 1983-1989 period in order to provide adequate protection to the trust funds should the poor performance of the economy persist.

DEFICIT REDUCTION STRATEGIES

Substantial reductions in the growth of benefits, large increases in revenues, or some combination of the two will be necessary to pay Social Security benefits in a timely fashion through 1988. Such changes will almost certainly affect a large proportion of beneficiaries or taxpayers. For example, the estimated impact on Social Security of the 1981 Reconciliation Act--including the total elimination of the minimum benefit, which later was partly repealed--was to reduce projected outlays for 1982-1986 by about \$22 billion, whereas OASDI needs at least \$71 billion in additional resources in the 1983-1988 period. Moreover, the remaining options for this type of limited benefit reduction would provide even smaller savings than those already enacted. Similarly, most options that would increase trust fund revenues by increasing payments by relatively small groups of taxpayers would not yield enough new revenue to meet the projected needs of the trust funds.

the beginning of each month. When evaluating the asset requirements for the trust funds on a fiscal year basis, however, balances equivalent to 12 percent of annual outlays represent a minimum reserve to avoid cash flow problems during the year. This reflects the fact that both expenditures and revenues vary during the year. The fluctuations on the benefit side occur largely as a result of annual benefit increases beginning each year in July. Tax revenues vary because of the timing of payments by state and local governments and by the self-employed, and because over the course of the year some workers reach the maximum earnings subject to the payroll tax and therefore stop contributing to the system for the remainder of the calendar year.

A wide range of possible outlay reductions that would affect most beneficiaries could generate significant savings in Social Security. To solve the short-term financing problem entirely through benefit reductions, however, would require either reductions in nominal benefits for current recipients or sharp reductions in benefits for new recipients. If such large benefit cuts are to be avoided, trust fund income will have to be increased, either through tax increases or through some form of general revenue financing. Although the introduction of general revenues would help to solve the Social Security financing problem, it would not reduce the federal budget deficit. Tax increases, in contrast, would both provide additional revenues for Social Security and narrow the budget deficit.

ACROSS-THE-BOARD REDUCTION STRATEGIES

Across-the-board changes in Social Security could provide significant outlay savings or revenue increases for both Social Security and the budget as a whole. Because the Social Security program is so large, even relatively small differences in cost-of-living adjustments (COLAs) or payroll tax rates, for example, could have major budgetary implications. By themselves, however, such changes might not provide the additional resources needed to solve the system's short-run financing problem.

Changes designed to remedy the long-run financing problem could also include either benefit cuts or tax increases. Possible benefit cuts that would generate long-run savings include altering the benefit formula and raising the age of retirement. Although they could produce significant long-run savings, such benefit cuts would affect relatively few beneficiaries over the next five years, and would therefore have relatively little impact in the near term. Similarly, payroll tax rate increases designed to reduce the long-term Social Security deficit would affect future generations of workers, but under current projections they would not need to be implemented until after 2010.

Changes Producing Additional Resources in the Short Run

In the next five years, either reductions in annual Social Security COLAs or increases in payroll tax rates could result in additional trust fund resources. ^{9/} These options would primarily affect current beneficiaries or

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9. Other across-the-board tax increases could also be enacted that would yield substantial new revenues. Alternatives to payroll tax rate increases that have been proposed in the past, but that are not analyzed here, include an income tax surtax, excise taxes, and taxes on imported fuels, with the resulting revenues in each case earmarked for the trust funds.

current taxpayers, and they would have similar impacts on all persons affected. Both of these types of options would also help to reduce the overall budget deficit.

Reduce Cost-of-Living Adjustments. COLAs for Social Security and other indexed entitlement programs could be reduced in several different ways. These options share some general advantages and disadvantages. 10/

Reductions in COLAs would slow the rate of growth of Social Security outlays, although they would not be sufficient to ensure the solvency of the system in the short run. Such reductions have often been suggested to offset the overindexing of benefits that resulted from flaws in the treatment of housing costs within the CPI, the index used to compute Social Security COLAs. Moreover, annual benefit increases in 1979-1981 exceeded average annual wage gains by a substantial margin--an outcome many observers believe was inequitable. In addition, current Social Security recipients are generally receiving rates of return on their contributions for Social Security that are very high compared with those that will be received by future retirees, both because of past flaws in the indexing mechanism, and because rates of return are relatively high for recipients before a pay-as-you-go system reaches full maturity.

On the other hand, COLA reductions would diminish the purchasing power of Social Security benefits over time and would lead to a higher incidence of poverty among the aged and disabled. Since most such reductions are cumulative from year to year, real benefits would be further reduced in each year of retirement if the cuts were sustained over an extended period; consequently, benefit levels, especially for the very old, could decline substantially. 11/ Although programs such as Supplemental Security Income (SSI) and Food Stamps provide some measure of protection

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10. In addition to COLA reductions designed to cut outlays, some analysts have proposed various options to tie benefit increases to an adjusted measure of wage growth instead of to the CPI, in order to reduce fluctuations in outlays relative to revenues. One such proposal, for example, would set the COLA equal to the increase in average wages minus 1.5 percentage points--the expected difference between wage and price growth over the long run. Such options are designed to stabilize the trust funds over the long term, rather than to produce short-run savings, and are therefore not discussed here.
 11. Even if full CPI indexing was restored in future years, benefit levels would be permanently lower, as would the annual benefit increases--in dollars--because of the reduction in the base.

for Social Security recipients with low incomes, the stringent asset test under SSI and the unwillingness of many aged and disabled persons to apply for means-tested benefits prevent many of the elderly poor from participating in these programs. To the extent that Social Security recipients do participate in such programs, however, savings from reductions in Social Security benefits could be partially offset by increases in outlays for Food Stamps and SSI. One approach that would cut federal spending while protecting the poorest of the elderly would be to combine reductions in Social Security COLAs with liberalization of the asset test and increases in benefit levels under SSI.

Table III-2 presents the savings from four major COLA options:

- o Delay the COLA by three months;
- o Cap the COLA at the CPI increase minus two percentage points through 1988;
- o Eliminate the 1983 COLA; and
- o Eliminate the 1983 and 1984 COLAs.

The savings from these options over the 1984-1988 period would range from about \$10.4 billion for a permanent shift of the COLA from July to October to \$67.1 billion from eliminating both the 1983 and the 1984 COLAs.

These options illustrate several commonly proposed types of COLA reductions; clearly, many other ways to reduce COLAs could also be designed. For all of these options, the total savings achieved relative to current law, the timing of the savings, and the total impact on benefit levels would depend on the rate of inflation over the next few years. Since inflation rates have recently declined and are expected to continue to be lower than in the recent past, none of these options would result in savings as large as if they had been enacted in 1980 or 1981.

Increase Payroll Tax Rate. Increases in the payroll tax rate constitute a second across-the-board strategy for reducing the deficits of both the Social Security system and the overall federal budget in the near term. As with COLA changes, the increases could take various forms, which would differ in both magnitude and timing. Similarly, there are advantages and disadvantages that apply to all variants of this general approach.

The OASDI payroll tax is already scheduled to rise from the current 5.4 percent (or combined employer-employee rate of 10.8 percent) to 5.7

TABLE III-2. IMPACT ON THE SOCIAL SECURITY TRUST FUNDS OF ACROSS-THE-BOARD CHANGES a/ (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Savings
Short-Run COLA Reductions						
Delay the COLA by Three Months	2.0	2.1	2.1	2.1	2.1	10.4
Cap the COLA at the CPI Increase Minus 2 Percentage Points Through 1988	4.2	7.8	11.5	15.3	19.1	57.9
Eliminate the 1983 COLA	6.8	6.9	6.9	6.7	6.4	33.7
Eliminate the 1983 and 1984 COLAs	8.8	14.8	14.8	14.6	14.1	67.1
Short-Run Payroll Tax Rate Increases						
Move 1985 Rate to January 1984	6.4	2.3	0	0	0	8.7
Move 1985 and 1990 Rates to January 1984	19.3	19.4	18.3	19.6	21.0	97.6
Long-Run Changes						
Restrict Increases in Formula Bend Points to 75 Percent of Wage Increases	<u>b/</u>	0.1	0.2	0.3	0.6	1.2
Lengthen Computation Period by Three Years	<u>b/</u>	0.1	0.3	0.5	0.7	1.6

a. The impact of these options on the federal budget deficit may be somewhat smaller than the trust fund effects shown here, due to offsetting increases in spending for other federal programs or reductions in federal tax receipts. For the options that would reduce spending, only the effects on outlays are shown in this table, because changes in budget authority (which includes interest) are uncertain when trust fund balances are negative and declining.

b. Less than \$50 million.

percent in 1985 and 6.2 percent in 1990. ^{12/} If these increases were implemented earlier, additional revenues could be raised in the short run without affecting long-run tax rates. Moving the increase scheduled for January 1, 1985 to 1984 would generate \$6.4 billion in additional receipts in 1984, and \$2.3 billion more in 1985. ^{13/} If the 1990 rate became effective in 1984, additional revenues of \$97.6 billion would be generated in 1984-1988.

Payroll tax rate increases would have the advantage of yielding substantial revenues, even with relatively small increases in the percentage of each worker's earnings going to pay for Social Security. In addition, payroll tax increases would reduce the need for benefit reductions, which could impose hardships on some recipients who may have little ability to adjust to unexpected changes in their incomes. Such tax increases would also continue the current method of financing Social Security.

On the other hand, tax rate increases would impose even higher payroll tax burdens on workers who have experienced Social Security tax-rate increases in four of the last six years--the OASDI tax rate has already risen from 4.95 percent in 1977 to a current level of 5.4 percent. ^{14/} For workers earning the maximum taxable wage, the effective tax increases have been even greater because the maximum has increased more than 100 percent over the same period, compared to a growth of about 50 percent in average wage levels. Moreover, moving the already-scheduled 1985 and 1990 tax increases to 1984 would represent a 15 percent increase in the Social Security taxes each worker would pay, and would reduce the take-home pay of workers, who have already experienced a decline in real earnings in recent years because of high inflation. In light of this effect, some observers have advocated providing income tax credits to offset some or all of the payroll tax increase. Such a tax credit would lessen or eliminate the

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12. Total Social Security tax rates--including the HI tax--are now 6.7 percent each for employers and employees, and are scheduled to rise to 7.05 percent in 1985, 7.15 percent in 1986, and 7.65 percent in 1990. The 1986 increase is to be allocated to the HI fund.
 13. These estimates do not include possible offsetting reductions in income tax receipts which could occur as a result of slower wage growth or reduced profits.
 14. Moreover, the HI tax rate increased from 0.9 percent to 1.3 percent over the same period, so that the total has gone from 5.85 percent to 6.7 percent, a total increase of 0.85 percentage points, or 14.5 percent.

effect of payroll tax increases on the deficit, however, and would essentially represent a form of general revenue financing.

Payroll tax increases may also have adverse effects on the performance of the economy. Economists generally agree that the ultimate burden of the payroll tax is borne either by workers (through lower real wages or slower wage growth) or by consumers (through higher prices), although businesses and the owners of capital may suffer reduced profits in the short run because they may be unable to adjust prices or wages quickly. Payroll tax rate increases may, therefore, raise the cost of labor in the short run and adversely affect employment or increase inflation. In addition, to the extent that payroll tax increases reduce real wages and increase prices, they may reduce consumption and the demand for goods and services. This is a matter of special concern now, when the rate of growth in the economy is already low.

Changes Affecting the Long-Range Financing Problem

Some OASDI changes primarily designed to address the projected long-range financing problem could also help to improve the financial status of the trust funds in the near term. As discussed earlier, most long-run options that would significantly reduce the benefits promised under current law include provisions for a gradual phase-in to allow workers and beneficiaries time to adjust their plans. Most proposals to raise the age of eligibility for retirement benefits, for example, are designed to be phased in after 1989. Even allowing for some phase-in, however, options such as changes in the benefit formula that would reduce initial benefits could produce some near-term savings. ^{15/}

Change Benefit Formula. The benefit formula could be altered to reduce initial benefits for all workers becoming eligible in the future, which would slow the growth in outlays. This could be done, for example, by slowing the adjustments for wage growth in the components of the benefit formula known as "bend points." For persons first becoming eligible for benefits in 1983, a worker's basic benefit--referred to as the Primary Insurance Amount (PIA)--is computed under the following formula: 90 percent of the first \$254 of the worker's Average Indexed Monthly Earnings (AIME), plus 32 percent of the next \$1,274 of AIME, plus 15 percent of the

15. For analysis of long-run financing options, see Congressional Budget Office, Financing Social Security: Options for the Long Run (November 1982).

AIME in excess of \$1,528. ^{16/} Under current law, the formula's bend points--\$254 and \$1,528--are increased each year by the increase in average earnings in the economy. If these bend points were increased more slowly than wages--say, by 75 percent of annual wage increases--the savings in Social Security outlays would amount to about \$1.2 billion for the 1984-1988 period. Such a proposal would also yield considerable long-run savings.

Under this proposal, the benefit formula would change so gradually that benefits for future retirees would not be lower in real terms--under current economic assumptions--than those received by workers now retiring. The gradual reduction in benefits would also give future beneficiaries some time to adjust to the change. On the other hand, this proposal would result in a further reduction in the rate of return on contributions for future retirees who, under current law, will already receive lower returns than current retirees. Moreover, this type of benefit reduction would increase the likelihood that the rate of return to high-wage workers would fall below what they could obtain in private markets.

Lengthen the Computation Period by Three Years. A second way to reduce initial retirement benefits for most retirees would be to change the number of years included in the benefit computation formula. As mentioned above, Social Security retirement benefits are based on workers' AIME. The number of years that currently must be included in the benefit computation formula is determined in part by the year in which the worker reaches age 62. ^{17/} The option discussed here would add three years to the AIME computation period, bringing it to the year in which the worker reaches age 65. Lengthening the averaging period would generally lower benefits, particularly for early retirees, by requiring more years of low earnings to be factored into the benefit computation. This proposal, applied to persons turning 62 after December 31, 1983, would save \$1.6 billion during the next five years.

Some would support such a change on the ground that the number of years included in the calculation of AIME should be based on the age of

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16. AIME is an adjusted measure of average monthly earnings over most of a worker's years of covered employment.
 17. Specifically, the length of the computation period is five years less than the number of years after 1950 or attainment of age 21, whichever is later, and before the worker reaches age 62, dies, or becomes disabled. Wages earned after a worker reaches age 62 may replace earnings from earlier years if this increases the benefit received. The averaging period for a worker turning age 62 in 1983 is 27 years, and will reach 35 years for those attaining age 62 after 1990.

eligibility for full benefits, not for reduced early-retirement benefits. Moreover, the longer averaging period--which would generally affect those retiring before age 65 the most--would reduce incentives for early retirement. On the other hand, because many beneficiaries elect early retirement for reasons such as poor health or joblessness, a longer computation period could reduce benefits for those recipients who are least able to continue working. Other workers who could be disproportionately affected include those who stop or interrupt their careers--for example women who remain at home to raise children.

TARGETED REDUCTION STRATEGIES

Social Security benefit reductions and revenue increases could also be focused on smaller groups of beneficiaries or workers. In order to achieve the same net effect on the trust funds and the budget as across-the-board strategies, such targeted changes would need to have much larger impacts on the affected individuals. ^{18/} On the other hand, such changes might be desirable for other reasons--improving work incentives for older workers, focusing benefit reductions on those less in need, or providing more uniform tax treatment under either the Social Security payroll tax or the federal personal income tax, for example. Even if all the options discussed below were combined, however, the aggregate savings would not be sufficient to ensure solvency for the trust funds.

Benefit Reductions

Benefit reductions that would affect specific groups of beneficiaries include:

- o Eliminating benefits for children of early retirees;
- o Applying the same limit on maximum family benefits for OASI beneficiaries as is used for families receiving DI; and
- o Increasing the waiting period for DI benefits by one month--that is, to six months.

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18. Some types of reductions might generate savings for Social Security, but much smaller savings for the overall budget as a result of increased spending for means-tested programs such as Supplemental Security Income, veterans' pensions, and food stamps. In such cases, participants in several programs would not necessarily be greatly affected by the Social Security cuts.

Eliminate Benefits for Children of Early Retirees. As long as a child of a retired worker is unmarried and under age 18, that child is eligible for a Social Security benefit equal to one-half of the basic benefit, subject to a dollar limit on the maximum amount received by any one family. ^{19/} If such benefits were eliminated for the children of retirees aged 62 through 64, the savings would total about \$1.6 billion over the next five years (see Table III-3).

TABLE III-3. IMPACT ON THE SOCIAL SECURITY TRUST FUNDS OF TARGETED STRATEGIES TO REDUCE SOCIAL SECURITY BENEFITS ^{a/} (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Savings
Eliminate Benefits for Children of Early Retirees	<u>b/</u>	0.2	0.3	0.5	0.6	1.6
Tighten the Limit on Family Benefits for OASI Beneficiaries	0.1	0.2	0.4	0.6	0.8	2.1
Increase the Waiting Period for DI Benefits to Six Months	0.2	0.2	0.2	0.2	0.2	1.0

a. The impact of these options on the federal budget deficit may be somewhat smaller than the trust fund effects shown here, due to offsetting increases in spending for other federal programs or reductions in federal tax receipts. For the options that would reduce spending, only the effects on outlays are shown in this table, because changes in budget authority (which includes interest) are uncertain when trust fund balances are negative and declining.

b. Less than \$50 million.

19. Benefits for post-secondary school students between the ages of 18 and 22 are currently being phased out.

This option might encourage some workers to stay in the labor force longer, since the younger workers are, the more likely they are to have children under 18 years of age; thus, under current law some workers under age 65 may be encouraged to retire early, while their children are still eligible for benefits. ^{20/} On the other hand, some families in which the parent was unable to continue working would receive lower benefits.

Tighten the Limit on Family Benefits for OASI Recipients. The current limits on maximum family benefits are stricter for DI beneficiary families than for OASI families. Under current law, the maximum DI family benefit equals the lesser of 85 percent of the worker's AIME (but not less than 100 percent of the PIA) or 150 percent of the PIA, whereas the OASI maximum ranges from 150 percent to 188 percent of the worker's PIA. ^{21/} If the DI limit were applied to all newly eligible OASI beneficiaries beginning in 1984, the 1984-1988 savings would total about \$2.1 billion.

Besides eliminating the present difference between the two programs and reducing OASI outlays, this option could also increase work effort by lowering benefits relative to earnings. Under current law, some OASI beneficiary families receive benefits that exceed pre-retirement after-tax earnings. On the other hand, the change would reduce benefits more for families with low basic benefits than for those with higher benefits--that is, it would make the system less progressive. In addition, in a period of high unemployment, little additional work effort among older workers is likely to occur.

Increase the Waiting Period for DI Benefits to Six Months. Disabled workers are required to be continuously disabled for five months before they are eligible for Social Security disability benefits. If the waiting period were increased to six months--the length before 1972--for workers becoming eligible after 1983 the five-year savings would amount to \$1.0 billion.

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20. In many cases this proposal would produce only a small reduction in benefits because of the family maximum benefit provision, which limits benefits payable from one earnings record to 150 percent to 188 percent of the worker's basic benefit. Thus, the increase in a household's total benefits attributable to the presence of eligible children would often be quite limited, and the work disincentive effects of these benefits might not be large.
 21. More specifically, the OASI maximum family benefit in 1983 is computed under the following formula: 150 percent of the first \$324 of PIA, plus 272 percent of the PIA over \$324 through \$468, plus 134 percent of the PIA over \$468 through \$610, plus 175 percent of the PIA over \$610.