This change would make DI eligibility rules conform to other Social Security provisions, as well as to many private disability plans. The Social Security Amendments of 1981, for example, required that the Social Security payroll tax be applied to the first six months of sick pay. A lengthening of the waiting period might also discourage some potential DI recipients from applying for benefits, although this impact would probably be very small. On the other hand, lengthening the waiting period would deny one month of benefits to all new DI beneficiaries, some of whom would have little income from other sources and high medical expenses.

Revenue Increases

Tax measures could also be targeted on portions of the beneficiary or working populations. Options analyzed here include:

- Taxing 50 percent of Social Security benefits for families with total incomes above $12,000 (individuals) and $18,000 (couples); and

- Increasing the self-employed tax rate to the combined employer-employee rate and allowing half of the payroll tax to be deducted as a business expense.

Tax 50 Percent of OASDI Benefits for Families with Total Incomes Above $12,000 (Individuals) and $18,000 (Couples). One way to generate new federal revenues would be to subject a portion of Social Security benefits to the personal income tax, as is done for Unemployment Insurance (UI) benefits received by those with incomes over certain limits. Under the proposal examined here, 50 percent of those benefits that, in combination with other income, result in total family incomes exceeding $12,000 for individuals and $18,000 for couples would be included as income for income tax purposes. 22/ This option would produce an estimated $29.7 billion in federal revenues during the 1984-1988 period (see Table III-4). If these receipts were channeled into the trust funds, their financial status would be improved by an equal amount.

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22. This is the same tax treatment as that accorded UI benefits, except that all of UI benefits, rather than half, are included as income for those with incomes substantially over the thresholds. For those with incomes near the thresholds, the proportion of benefits that is subject to income taxes is graduated from 50 to 100 percent, depending on how far the family is above the income limits.

TABLE III-4. REVENUE GAINS FROM TARGETED STRATEGIES TO INCREASE SOCIAL SECURITY TAXES (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Increase
Tax 50 Percent of OASDI Benefits for Families with Total Incomes Above $12,000 (Individuals)/ $18,000 (Couples)						
Trust fund revenues	1.7	5.8	6.6	7.4	8.2	29.7
Unified budget revenues	1.7	5.8	6.6	7.4	8.2	29.7
Increase Self-Employed Tax Rate to Combined Employer-Employee Rate and Allow 50 Percent of Payroll Tax to Be Deductible						
Trust fund revenues	0.9	2.7	2.9	3.1	3.3	12.9
Unified budget revenues	0.4	1.3	1.4	1.5	1.6	6.2

The current practice of excluding Social Security benefits from taxation is not based on specific legislation, but rather on a 1941 Internal Revenue Service ruling that they are in the nature of welfare payments. In 1941, most recipients were classified as poor. Although many beneficiaries are still poor--about 15 percent of the elderly have incomes below the poverty line--most recipients are not. Moreover, the income limits in this proposal would protect even those well above the poverty line from any increases in income tax liabilities.

Taxation of Social Security benefits would reduce the differences in treatment between Social Security benefits and other pensions and would be

similar to an income-targeted benefit cut. 23/ In addition, it would remove the incentive to retire early that results because the tax-exempt nature of Social Security benefits raises the value of benefits relative to earnings. Taxing benefits could also reduce differences in the return received on their contributions by those in different generations. Current Social Security recipients generally receive benefits well in excess of their past contributions. If this excess of benefits over contributions is reduced, lower tax payments will be needed from the present generation of workers.

On the other hand, beneficiaries who had earnings at or near the maximum taxable level would be more likely than others to have other sources of retirement income and thus to be affected by this proposal, which would further reduce rates of return on contributions received by such workers. In addition, if revenues were channeled to the trust funds, this type of proposal might also be seen as a form of general-revenue financing for Social Security, which some oppose. They believe that this approach would set a precedent for increasing general revenue support in the future and would lessen the fiscal discipline imposed by payroll tax financing. They also point out that the taxes on UI benefits are not returned to that program's trust fund, and thus it would not be parallel treatment to increase Social Security revenues in this manner.

Increase the Self-Employed Tax Rate to the Combined Employer-Employee Rate and Allow 50 Percent of Payroll Tax to Be Deducted. The OASDI tax rate that applies to self-employment earnings is roughly 75 percent of the combined employer-employee rate. Increasing the self-employed rate to the total applied to the earnings of wage and salary workers would raise an additional $0.9 billion in OASDI revenue in 1984, and $12.9 billion for the 1984-1988 period. If, at the same time, one-half of the tax payments of the self-employed were made deductible for income tax purposes, unified budget revenues would increase by a net amount of $0.4 billion in 1984 and $6.2 billion over the next five years.

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23. For example, a 1983 retiree aged 65 who always earned the maximum earnings under Social Security would receive approximately $8,700 in Social Security benefits in 1983 and, if there were no other sources of income, would pay no income taxes. On the other hand, if this amount were the benefit paid under another pension plan--such as Civil Service Retirement--and the employee contributions had already been exceeded, the individual's income tax liability for 1983 would amount to about $640, assuming the standard deduction was used.

The combination of these two changes in tax law would result in a uniform treatment of all earnings for both Social Security and income tax purposes, regardless of whether they were those of the self-employed or of wage-and-salary workers. On the other hand, this proposal would increase total tax liabilities--that is, Social Security taxes and personal income taxes--for most self-employed individuals. Only the self-employed for whom the entire payroll tax deduction would come from taxable income in the 50 percent marginal tax bracket would be unaffected; the largest increases in overall taxes would be paid by self-employed workers with the lowest incomes. Moreover, this proposal essentially represents a general revenue infusion, which some oppose.

Extend Social Security Coverage

A third type of targeted option that would generate additional resources for Social Security--and, to a lesser extent, for the unified budget --would be to extend Social Security coverage to some employment now not covered under the system. Approximately 90 percent of all jobs in the economy are covered under Social Security. Three major groups of workers, however, could be added to the system:

- Federal civilian employees;
- State and local government employees; and
- Employees of nonprofit organizations. 24/

Extending Social Security coverage to these additional groups of workers would also eventually cause them to receive higher Social Security benefits, raising outlays as well as revenues in the long run. The arguments for and against coverage differ by type of worker and are discussed separately below.

Cover Federal Civilian Workers. If all new federal employees, as well as those with fewer than five years of service, were covered by Social Security beginning in 1984, OASDI trust fund income would be increased by about $12.6 billion over the 1984-1988 period (see Table III-5). The federal workers then covered under Social Security would also participate in a revised Civil Service Retirement (CSR) plan that would supplement Social Security. The impact of this option on unified budget revenues would depend on the specific modifications enacted in the CSR system.

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24. Of these three groups, 90 percent, 30 percent, and 20 percent, respectively, are not now covered by Social Security.

TABLE III-5. REVENUE GAINS FROM EXTENDING SOCIAL SECURITY COVERAGE (In billions of dollars)

Options	1984	1985	1986	1987	1988	Cumulative Five-Year Increase
Cover Federal Civilian Workers with Fewer Than Five Years of Service						
Trust fund revenues	1.1	1.9	2.6	3.2	3.8	12.6
Unified budget revenues a/	0.6	1.0	1.3	1.6	1.9	6.4
Cover New State and Local Government Employees						
Trust fund revenues	0.1	0.2	0.4	0.5	0.7	1.9
Unified budget revenues	0.1	0.2	0.4	0.5	0.7	1.9
Cover All Employees of Nonprofit Organizations						
Trust fund revenues	0.9	1.3	1.6	1.8	2.1	6.7
Unified budget revenues	0.9	1.3	1.6	1.8	2.1	6.7

a. Estimate is based on the assumption that the CSR contribution rate would be unaffected, so new federal employees would pay both Social Security taxes and CSR contributions. Alternatively, if the supplementary pension plan paralleled most private plans by requiring no employee contribution, reductions in the federal deficit would be much smaller and would primarily consist of employers'-share payments from the Postal Service.

Proponents of coverage for federal workers argue that approximately three-quarters of all federal annuitants eventually receive Social Security benefits, either on the basis of their own nonfederal earnings or as spouses of Social Security beneficiaries. Also, career federal workers who spend a relatively small proportion of their working lives in covered employment receive higher rates of return on their Social Security contributions than most workers, as a result of the progressive benefit formula that was designed to help those with low lifetime earnings. If federal workers were covered by Social Security, they would pay the same amount for their benefits as other workers with similar total earnings. In addition, many federal workers would receive better disability and survivor protection under Social Security than under the present CSR system, especially those who die or become disabled before accruing five years of federal employment.

Extending Social Security coverage to federal employees would require modification of the Civil Service Retirement system to reflect the Social Security payroll tax and benefit structure, however (see Chapter VIII). Depending on the changes in the CSR system, at least some career federal workers would be likely to receive lower benefits than under current law. The CSR system, for example, has a less stringent definition of disability and earlier eligibility ages for retirement benefits than does the Social Security system. 25/

Cover New State and Local Government Employees. Under current law, state and local governments have the option of not participating in the Social Security system and, as a result, about 30 percent of their employees are not currently covered. Gradually bringing these jobs into Social Security by covering new state and local employees would raise $1.9 billion in 1984-1988 and would reduce the unified budget deficit by a like amount.

The advantages of this proposal for state and local workers are similar to those for federal workers. In particular, Social Security coverage is portable--that is, transferable from job to job--and disability and survivors' benefits are often better, particularly for younger workers.

On the other hand, imposing coverage of all new state and local government workers could encounter opposition on two grounds--constitutional difficulties and state and local government costs. There is considerable disagreement about whether the federal government can, under the Constitution, require states to pay the employer share of the payroll tax. In

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25. This is true not only of the CSR system. The requirements of disability programs that are available through private employers are generally less strict than those of the DI program.

addition, the costs to these governments of paying both Social Security contributions for current workers and retirement benefits for current retirees--since many of these plans, too, are funded on a pay-as-you-go basis--could be greater than the costs of their current systems. These increased costs would be incurred at a time when many state and local governments are in financial distress.

Cover All Employees of Nonprofit Organizations. Social Security coverage of the employees of nonprofit organizations is now voluntary. Mandatory coverage starting in 1984 would generate $6.7 billion in new trust fund revenues during the next five years and an equal amount in total federal revenues. The advantages for these employees would be the same as for state and local workers--a benefit package that is portable, and in many cases more generous than their current one.

On the other hand, for many nonprofit employers, Social Security coverage would represent a substantial increase in the costs of employment. Since the reason that many of these organizations are not part of Social Security is its cost, mandatory coverage might lead to some reduction in employment.

RECOMMENDATIONS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

In its final report, the National Commission on Social Security Reform (NCSSR) recommended a set of proposals that, if enacted, would provide additional trust fund revenues or decreased outlays that it estimated would total $168 billion over calendar years 1983-1989. The recommended financing package, therefore, would achieve the goal of $150 billion to $200 billion in additional resources that the NCSSR agreed was required to provide adequate funding for the OASDI programs in the event that the economy performs poorly. The proposals would do considerably less to improve the outlook for federal budget deficits, however, because roughly one-third of the $168 billion represents either transfers from the general fund or amounts that would be offset by increases in spending for other federal programs or by reduced tax revenues.

Certain recommendations, such as expanding the Board of Trustees, removing the Social Security and Medicare trust funds from the unified budget, and reallocating the tax rates between the OASI and DI funds, address administrative or accounting concerns and would have no direct impact on either Social Security financing or the overall federal deficit. Other proposals, such as indexing benefits by the lesser of wage or price

increases when trust fund balances are low, could have OASDI financing and federal budget effects, but only under certain economic conditions that the CBO does not currently project.

This section provides a brief analysis of the NCSSR's recommendations and their implications for reducing federal budget deficits in the fiscal year 1984-1988 period. As such, the estimates cannot be directly compared to the commission's, because the latter's estimates are on a calendar year basis and extend through 1989. 26/

The commission recommendations that would have major short-term impacts on the trust funds include:

- Delaying the COLA six months;
- Taxing OASDI benefits for higher-income recipients;
- Increasing payroll tax rates in 1984 and 1988;
- Increasing the tax rate for self-employed workers;
- Extending coverage to new federal workers and all employees of non-profit organizations; and
- Crediting the trust funds for gratuitous military service wage credits.

Many of these proposals are variants of options discussed above.

Postpone the Cost-of-Living Adjustment

The NCSSR proposed that OASDI benefits be reduced by enactment of a permanent six-month delay in the annual cost-of-living adjustment. Thus, the annual COLA that currently affects the June benefit (received by beneficiaries in July) would be reflected in the following December's check (received in January) instead. The CBO estimates that this change in the

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26. Moreover, the commission's report is not specific with regard to some of its proposals--for example, the details of the phasing-in of benefit taxation for those with incomes over the taxable thresholds are not discussed. CBO's estimates may also differ from the commission's, therefore, as a result of differences in assumptions regarding the implementation of the proposals.

COLA would reduce OASDI payments by $24.1 billion over fiscal years 1983-1988 (see Table III-6). At the same time, the commission proposed that the SSI program be modified to allow beneficiaries receiving both SSI and Social Security benefits to retain $30 more in total benefits each month to offset the impact of the Social Security COLA delay. Consequently, the OASDI savings would be offset by about $4.2 billion in increased spending for SSI over the same period. In addition, the proposed change would increase benefit payments in other programs, resulting in further reductions in the budget savings of about $0.8 billion over the same period. 27/

Tax Social Security Benefits

The commission also recommended that one-half of OASDI benefits be considered as taxable income for recipients with adjusted gross income (not including OASDI benefits) of at least $20,000 if single, and $25,000 if married and filing jointly. The resulting increase in federal revenues would be credited to the OASDI trust funds.

As discussed earlier in this chapter, the current tax treatment of OASDI income differs from that accorded other pensions. The commission's proposal would move in the direction of comparability, but the income thresholds, and the fact that only 50 percent of benefits (rather than the excess of benefits over contributions) would be taxed, would continue some preferential tax treatment of Social Security benefits. Although taxing benefits would increase revenues rather than reduce outlays, many view the proposed change as more closely approximating an income-targeted benefit cut instead of a tax increase.

In recommending this tax treatment of benefits, the commission acknowledged that its specific proposal would result in greatly different tax liabilities for persons with incomes close to the thresholds, and it assumed that this "notch" problem would be corrected in the legislative process. Consequently, two illustrative tax treatments are considered here. The first approximates the current practice for taxing UI benefits. More specifically, if adjusted gross income plus 50 percent of OASDI benefits exceeded the $20,000/$25,000 thresholds, then one dollar for each two dollars of the excess would be added to adjusted gross income up to the limit of 50 percent

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27. These estimates are based on the assumption that the SSI COLA would not be delayed six months, since the commission did not specify any change. Offsetting increases in SSI and other programs would be much smaller if the SSI COLA were also delayed.

TABLE III-6. ESTIMATED IMPACT OF THE NATIONAL COMMISSION'S PROPOSALS ON OASDI TRUST FUNDS (In billions of dollars)

	1983	1984	1985	1986	1987	1988	Total 1983-1988
			Trust Fund Outlay Reductions				
Delay COLA from July to January	1.7	3.8	4.2	4.5	4.7	5.2	24.1
Miscellaneous Benefit Provisions a/	0	-0.1	-0.2	-0.3	-0.3	-0.4	-1.3
Total Outlay Reductions	1.7	3.7	4.0	4.3	4.4	4.8	22.8
			Trust Fund Income Increases				
Tax 50 Percent of OASDI Benefits b/	0	1.2	4.2	4.9	5.6	6.4	22.4
Increase Payroll Tax Rate	0	6.4	2.3	0	0	10.3	19.0
Increase Self-Employed Tax Rate	0	1.0	3.0	2.9	3.1	3.5	13.6
Extend Coverage c/	0	1.0	1.9	2.5	3.2	4.3	12.9
Credit Trust Funds for Military Wage Credits and Reimbursement for Uncashed Benefit Checks	19.9	-0.3	-0.4	-0.4	-0.1	-0.1	18.6
Total Income Increases	19.9	9.4	11.1	9.9	11.8	24.5	86.6
Total Reductions in Outlays and Increases in Income	21.6	13.1	15.1	14.3	16.2	29.3	109.6
Estimated Increase in Interest Income	0.3	2.9	4.4	5.8	6.8	8.3	28.5
Total Increase in OASDI Trust Funds	21.9	16.0	14.5	20.0	23.0	37.6	138.1

NOTE: Preliminary CBO estimates. Components may not add to totals due to rounding. Negative numbers indicate outlay increases or revenue reductions.

a. Provisions include increasing benefits for certain groups of widowed and divorced persons, and decreasing benefits to persons with pensions from employment not covered by Social Security.

b. Estimate assumes that taxes on OASDI benefits would be phased in the same way as are taxes on Unemployment Insurance benefits.

c. Estimate includes effect of prohibiting the withdrawal of state and local governments from Social Security.

of all Social Security income. This formulation would eliminate the notch and would yield roughly $22 billion in new revenues over the 1984-1988 period, but it would increase income tax liabilities for some taxpayers with adjusted gross incomes below the threshold. 28/ This type of tax treatment would increase tax liabilities for about 3.3 million tax-filing units.

An alternative treatment would limit the impact of the proposal to only those with adjusted gross income (not including Social Security benefits) at or above the $20,000/$25,000 thresholds. One possible plan would add one dollar of benefits to taxable income for every two dollars of adjusted gross income above the threshold, up to a maximum of 50 percent of benefits. While this treatment would lessen the effects of the notch somewhat, and would not affect any beneficiaries who now have taxable incomes below the thresholds, it would also yield about 15 percent less in new revenues than would a phase-in like that used in the UI program.

Increase Payroll Tax Revenues

Under the NCSSR's recommendations, payroll tax receipts would be increased in three ways:

- Raising the payroll tax rate in 1984 and 1988;
- Raising the self-employed tax rate to the combined employer-employee rate; and
- Extending coverage to newly hired federal civilian workers and all employees of nonprofit organizations, effective January 1, 1984.

Each of these proposals would increase revenues for the OASDI trust funds by more than for the federal budget, because of offsetting reductions in income tax receipts, and because employer contributions by federal agencies would not constitute new federal revenues.

Raise Payroll Tax Rates. The commission proposed raising OASDI payroll tax rates for employers and employees in 1984 from 5.4 percent each

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28. A retired couple with $22,000 of adjusted gross income and $8,400 in OASDI benefits--roughly the average retired couples' benefit--would pay some additional income taxes, for example. Because $22,000 plus $4,200 (50 percent of OASDI income) exceeds the threshold, this couple would add $600 ($22,000 + $4,200 - $25,000 = $1,200; $1,200 x 0.5 = $600) to its taxable income.

to 5.7 percent each (this increase would go into effect in 1985 under current law), and to 6.06 for 1988 and 1989 (see Table III-7). 29/ In addition, for 1984 only, the commission recommended enacting a refundable income tax credit for the employee's share only, which would equal the increase in OASDI taxes over the current law level. Thus, while the 1984 increase in payroll tax rates would increase Social Security revenues by $6.4 billion in 1984 and $2.3 in 1985, its impact on the federal budget deficit would be only about half as large.

TABLE III-7. OASDI TAX RATES UNDER CURRENT LAW AND UNDER COMMISSION RECOMMENDATIONS, 1984-1989 (In percents)

	Employers and Employees, Each		Self-Employed	
	Current Law	Commission Proposal	Current Law	Commission Proposal
1984	5.4	5.7	8.05	11.4
1985	5.7	5.7	8.55	11.4
1986	5.7	5.7	8.55	11.4
1987	5.7	5.7	8.55	11.4
1988	5.7	6.06	8.55	12.12
1989	5.7	6.06	8.55	12.12

Raise the Self-Employed Tax Rate to the Combined Employer-Employee Rate. The commission recommended that the self-employed be required to pay the combined employer-employee rate, but that one-half of the tax be allowed as a deductible business expense--a proposal identical to the option described earlier in this chapter. The estimated revenue increase presented here is slightly higher--$1.0 in 1984--than that shown earlier, however, because of the increases in tax rates recommended by the commission (see Table III-7).

29. The tax rate increases to 6.2 percent in 1990 under current law.

Cover New Federal Workers and All Employees of Nonprofit Organizations. Extending Social Security coverage to new federal workers and all employees of nonprofit organizations would, when combined with the proposed tax rate increase, yield $12.9 billion in increased trust fund revenues over the 1984-1988 period. This proposal, which is similar to options discussed earlier in this chapter, would raise about $12.7 billion in new federal revenues over the same period. 30/

Other Recommendations Affecting OASDI Financing

A credit to the OASDI trust funds of $19.1 billion in 1983 was also proposed by the commission to compensate for gratuitous military service wage credits granted before 1983. The proposed lump-sum payment from the general fund would also include a reimbursement for Social Security checks--$0.8 billion--that have been issued but never redeemed. This transfer would provide the trust funds with additional resources when they most need them, but would have no impact on the federal deficit.

The commission also recommended a number of relatively small program changes that would have limited impacts both on Social Security financing and on the budget. 31/ For example, proposed increases in the benefits of certain types of recipients such as divorced spouses and disabled, widowed persons--predominantly women--would increase outlays by approximately one billion dollars over the next five years. On the other hand, the commission agreed that the benefits received by persons who are career workers in noncovered employment should be reduced, a change that would lower costs slightly.

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30. The estimate of the increase in federal revenues under this proposal includes the effects of extending the HI tax to employees of non-profit organizations, and also assumes that new federal employees would continue to make a 7 percent CSR contribution. The new revenues would be much lower, if, like most private pension plans, the supplementary CSR pension plan for new employees required a smaller employee contribution, or even no contribution.

31. Some recommendations, if enacted, could affect Social Security financing under some circumstances, but the CBO does not estimate any savings at this time. These include proposed changes in trust fund investment practices, and indexing benefits by the lower of wage increases or price increases, if trust fund balances are low.

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Finally, the commission called for a reallocation of the total OASDI tax rate between the two funds to apportion the revenues more closely to the requirements of each fund. In addition, authority for OASDI to borrow from HI would be extended through 1987, but HI would not be allowed to borrow from the OASDI funds. 32/

Overall Effect of the Commission's Proposals on the Trust Funds and the Budget

As indicated in Table III-6, the CBO estimates that the commission's proposals would provide an additional $138 billion to the OASDI trust funds (including additional interest income on higher trust fund balances) over the 1983-1988 period. Thus, the commission's recommendations would yield about $67 billion more over the period than the CBO estimates would be required to maintain a minimum start-of-year balance of 12 percent, provided the economy's performance is not worse than currently forecast.

Table III-8 presents a comparison of the CBO estimates of OASDI trust fund ratios--start-of-year balances as a percent of annual outlays--over the 1983-1988 period under current law and under the commission's recommendations. In contrast to the current-law estimates, under which trust fund reserves are seen to decline steadily, the estimated effects of the commission's package show both OASDI and OASDI-HI balances starting to rise beginning in 1986. By the beginning of 1988, OASDI trust fund balances would reach 28.6 percent of annual outlays, thus providing the trust funds some margin for safety against adverse economic conditions. The estimates also indicate that these changes would not provide a large cushion in the next few years, however, which could result in further problems if the economic recovery is weaker, or occurs more slowly, than is now projected.

The impact of the commission's proposals on the overall budget deficit would be somewhat smaller than the effects on the trust funds (see Table III-9). Federal deficits for the 1984-1988 period would be reduced by a total of about $75 billion. The deficit-reducing effect of the proposals would increase each year, with the reductions ranging from $8.8 billion in 1985 to $26.5 billion in 1988. The proposed deficit reductions would be relatively small when compared to the overall deficit, however--amounting to only about 10 percent of the projected 1988 deficit, for example.

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32. Authority for the OASI trust fund to borrow from the DI and HI trust funds was granted by the 97th Congress but expired in December 1982.

TABLE III-8. OASDI AND OASDI-HI START-OF-YEAR BALANCES AS A PERCENT OF ANNUAL OUTLAYS UNDER CURRENT LAW AND COMMISSION PROPOSALS

	1984	1985	1986	1987	1988
Current Law					
OASDI	7.3	-2.6	-8.3	-11.6	-14.3
OASDI-HI	10.2	1.9	-3.2	-6.7	-11.1
Commission Recommendations					
OASDI	19.6	17.1	19.7	23.7	28.6
OASDI-HI	20.1	17.7	18.9	20.8	21.9

Removing the Social Security and Medicare Trust Funds from the Unified Budget

A majority of the NCSSR supported a recommendation to remove the OASI, DI, HI, and Supplementary Medical Insurance trust funds from the unified budget. Proponents of this change argue that, since Social Security is supported by earmarked taxes, it should not be considered as part of the overall federal budget process. On the other hand, enactment of this proposal would do nothing to change either the financial status of the trust funds or the overall size and economic impact of the federal government. Further, it would complicate budget accounting and would force analysts and policymakers to add these programs back into the budget totals when examining the size and impact of the total federal government.

Under current policy projections, the four Social Security trust funds will contribute to the unified budget deficit during the 1984-1988 period. If Social Security and Medicare were administered by "off-budget" agencies, the remaining budget would have deficits that ranged from $9 billion to $17 billion lower, because the excess of outlays over revenues for the trust funds would no longer be included.

In contrast, if the commission's proposals were enacted, OASDI trust fund revenues would exceed outlays throughout this period, so that moving

TABLE III-9. ESTIMATED IMPACT OF THE NATIONAL COMMISSION'S PROPOSALS ON UNIFIED BUDGET DEFICIT (In billions of dollars)

	1983	1984	1985	1986	1987	1988	Total 1983-1988
			Outlay Reductions				
Delay COLA from July to January a/	1.4	3.0	3.3	3.8	4.0	4.4	19.9
Miscellaneous Benefit Provisions	0	-0.1	-0.2	-0.3	-0.3	-0.4	-1.3
Total Outlay Reductions	1.4	2.9	3.1	3.5	3.7	4.0	18.6
			Revenue Increases				
Tax 50 Percent of OASDI Benefits b/	0	1.2	4.2	4.9	5.6	6.4	22.4
Increase Payroll Tax Rate with Refundable Tax Credit c/	0	6.5	-2.0	0	0	10.3	14.8
Increase Self-Employed Tax Rate with 50 Percent to be Deductible	0	0.5	1.5	1.4	1.5	1.7	6.6
Extend Coverage d/	0	1.2	2.0	2.5	3.0	4.0	12.7
Total Revenue Increases	0	9.4	5.7	8.8	10.1	22.5	56.5
Total Reductions in Unified Budget Deficit	1.4	12.3	8.8	12.3	13.8	26.5	75.1

NOTE: Preliminary CBO estimates. Components may not add to totals due to rounding. Negative numbers indicate outlay increases or revenue reductions.

a. Estimate includes increased SSI outlays resulting from the $30 increase in the amount of OASDI benefits not counted when determining SSI benefits, as well as increased outlays in other programs.

b. Estimate is based on a tax treatment similar to that used for Unemployment Insurance benefits.

c. Estimate also includes increased Railroad Retirement taxes.

d. Estimate includes effect of prohibiting the withdrawal of state and local governments from Social Security, and HI taxes for newly covered workers.

Social Security off budget could actually increase the deficit in the programs that remained on budget. Under either current law or the commission's plan, however, the deficit for the entire federal government--as opposed to the on-budget portion--would be unaffected by this proposal.

CONCLUDING COMMENTS

The Social Security system faces major financing problems in both the short and the long run, and some changes are imperative within the next year if benefits are to be paid in a timely fashion. Options that would improve Social Security trust fund balances would often, but not always, reduce the federal budget deficit as well. In particular, general revenue financing for some portion of Social Security benefits would improve trust fund balances, but it would leave the federal deficit unchanged. Other options, such as coverage of federal employees, would have varying effects on the trust funds and on the federal budget. (The budgetary impact of this option would depend on the modifications made in the Civil Service Retirement system.) In general, across-the-board options such as COLA reductions or payroll tax increases would do most to reduce the budget deficit while improving the short-run financial outlook for the trust funds.

CHAPTER IV. MEDICARE AND MEDICAID

Outlays for Medicare and Medicaid are projected to grow faster than the budget as a whole in coming years. The major pressure forcing up outlays is the rising cost of medical care. Until some way is found of containing medical care costs, these programs will continue to experience serious financing problems.

Medicare provides health insurance for 26 million persons aged 65 and over and nearly 3 million disabled persons. It consists of two programs--the payroll-tax-financed Hospital Insurance (HI) program and the voluntary Supplementary Medical Insurance (SMI) program that pays for physician services. The latter is financed by premiums (about one-quarter) and an appropriation from general revenues (about three-quarters). 1/

The Medicaid program provides matching funds to states to finance medical care for low-income persons who are in families with dependent children, or who are aged, blind, or disabled. 2/ Medicaid coverage varies by state, but always includes a broader array of services than Medicare. At present, 44 percent of its expenditures go for nursing home care and home health services.

BUDGET HISTORY AND PROJECTIONS

Both programs grew very rapidly throughout the 1970s and up to the present, although growth in Medicaid has slowed somewhat of late, principally because of program cuts by both federal and state governments.

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1. Except for payment of a deductible equal to one day's hospitalization--$304 at present--Medicare covers in full the first 60 days of hospitalization for a spell of illness. Significant coinsurance is required for longer stays. Limited skilled nursing facility and home health services are also covered, focused on recuperation from acute illness. After a $75 annual deductible, Medicare pays 80 percent of allowed charges for medical and health-related services and supplies, including payments to physicians and hospital outpatient facilities.

2. The federal share is based on state per capita income. In 1983, it will vary from 48 percent to 75 percent, with an average of 54 percent.

Growth in both programs is expected to moderate somewhat over the next few years as a result of budget cuts and other factors, but outlays will nevertheless grow significantly faster than the budget as a whole and cause serious financing problems for Medicare.

TABLE IV-1. FEDERAL OUTLAYS FOR MEDICARE AND MEDICAID
(In billions of dollars)

Major Program	Actual 1980	Actual 1982	Estimated 1983	Baseline Projection 1984	1985	1986	1987	1988
Medicare	35.0	50.4	57.1	65.4	74.0	85.2	98.7	112.1
Hospital Insurance	24.3	34.9	38.9	44.3	49.7	57.3	66.4	74.7
Supplementary Medical Insurance	10.7	15.6	18.2	21.1	24.3	27.9	32.3	37.3
Medicaid	14.0	17.4	19.4	21.3	24.1	26.2	28.7	31.4

Recent History, 1980-1982

Rapidly rising Medicare outlays continued during the 1980-1982 period, but growth in Medicaid slowed somewhat. Outlays for Medicare increased at an annual rate of 20.0 percent during this period, compared with a rate of 12.2 for the budget as a whole (see Table IV-1). Rapid increases in the cost of medical care were the principal cause, with growth in the eligible population and its aging explaining only two percentage points of the Medicare increase. Medicare outlays would have been even higher if not for program reductions enacted as part of the Omnibus Budget Reconciliation Act of 1981. 3/

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3. These included an increase in the deductible amounts in both the hospital and the physician parts of the program, a tightening of the limits on per diem reimbursements of hospitals for routine costs, and a reduction in the size of extra payments intended to offset the presumed higher nursing costs of Medicare patients (known as the nursing differential). These changes caused 1982 outlays to be about 1 percent lower than they would otherwise have been.