
CHAPTER V. CHANGING THE AGE OF RETIREMENT

One frequently recommended solution for the long-term problem of financing rapid increases in the ratio of beneficiaries to workers during the early 21st century is to raise the retirement age.¹ This would expand the pool of workers and decrease the number of beneficiaries. Proponents argue that because life expectancies are increasing, total lifetime benefits per worker will rise considerably under current law. An increase in the retirement age could simply require workers to spend at least some of this increased life expectancy in employment rather than in retirement. On the other hand, a higher retirement age could impose hardships on certain groups of aged workers who might be relatively less able to adjust to such an increase--those in poor health who do not qualify for disability benefits, for example, or the chronically unemployed.

This chapter focuses on options for increasing the age of retirement. The first section describes current retirement practices, both with regard to Social Security policy and with reference to the actual behavior of workers. The next section analyzes several specific options for change. The last section details some of the major factors that affect the age of retirement, and outlines the advantages and drawbacks of proposals for later retirement as they relate to each of these factors.

CURRENT RETIREMENT PRACTICES

Sixty-five has been the age at which a worker becomes eligible for unreduced retirement benefits since the passage of the original Social Security Act in 1935. It was not selected after scientific or gerontological analysis, but rather because it was deemed to be the most acceptable age.²

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1. The 1975 and 1979 Quadrennial Advisory Councils on Social Security, the 1981 National Commission on Social Security, and the President's Commission on Pension Policy, for example, all discussed versions of this option.
 2. See Wilbur J. Cohen, Retirement Policies Under Social Security (University of California Press, 1957) for discussion of this point.

An element of flexibility was later introduced by permitting early retirement at ages 62-64, but with lower benefits. In addition, workers who delay retirement beyond age 65 receive increased benefits.³

The actual pattern of retirement behavior indicates that no single age may be accurately described as "normal." Roughly two out of every three Social Security retired worker beneficiaries begin receiving benefits before age 65. In addition, approximately 20 percent of the age 65-69 population are employed, although some also receive retirement benefits.

POLICY OPTIONS

Social Security could be redesigned in two basic ways to delay retirement. One would be to increase the relative benefits from delaying retirement. The other would be to raise the retirement age. In either case, changes in other programs such as Disability Insurance (DI) and Supplemental Security Income (SSI) could also be made in order to mitigate the adverse impacts of retirement age changes.

Increasing the Relative Benefits for Delayed Retirement

Incentives for later retirement could be increased either by providing greater rewards for those who continue to work or by further reducing the benefits for those who retire early.

Increasing the delayed retirement credit to the same level as the factor used to reduce benefits for those who retire early would probably result in workers remaining employed longer after turning 65, but would not result in long-term outlay savings.⁴ If the delayed retirement credit was

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3. Benefits are reduced by 5/9ths of 1 percent for every month of benefits received prior to age 65, with the maximum reduction being 20 percent for those retiring at age 62. This rate of reduction was chosen in order to make expected total lifetime benefits for all retirees with a given PIA approximately the same, regardless of when they actually retire. For each month retirement is delayed (up to age 72), benefits are increased by one-quarter of 1 percent, or 3 percent per year.
 4. In fact, because of the benefit recomputation provision, additional earnings might result in increased outlays. See Appendix A for an example of the effects of benefit recomputations.

increased to roughly 9 percent per year,⁵ workers who now retire at ages 65 to 70 could be expected to work on average about two to three months longer than under current law. Most of the increase in benefits would go to higher-earning beneficiaries, who are more likely to remain employed than are those with lower earnings.

In contrast, reductions in pre-age 65 benefits could result in major cost savings. For example, if benefits at age 62 were reduced to 55 percent of full benefits rather than the current 80 percent, as proposed by the Administration in May 1981, the estimated savings over 75 years could be as much as 0.7 percent of payroll (see Table 7). These savings would result primarily from reduced benefits received by those continuing to retire early, however, rather than from increases in the average age of retirement. If almost all retirees delayed their retirement until 65 as a result of this proposal, there would be no savings.⁶

Other more limited benefit reductions could also be instituted to encourage some persons to work longer. For example, benefits for children of early retirees could be eliminated, since they may provide an added incentive for some workers to apply for benefits before reaching age 65, while their children are still young enough to be eligible. Since only a relatively small portion of early retirees have young children, however, elimination of such benefits would probably have only a small effect on early retirements. Long-run cost savings resulting from this proposal would also be small--only about 0.02 percent of payroll.

Increasing the Eligibility Age

Raising the age of eligibility for full retirement benefits from 65 to 68 is one of the most commonly mentioned options for reducing Social Security costs, and would result in substantial savings. For example, under the Alternative II-B assumptions of the 1982 Trustees' Report, increasing the retirement age to 68 (and from 62 to 65 for early retirement benefits) over

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5. The specific proposal is to increase the credit so that it would be "actuarially fair." That is, the expected lifetime benefits for a given worker would be the same regardless of the age at which benefits were first received.
 6. For further discussion of this and other options to increase retirement ages, see Congressional Budget Office, Work and Retirement: Options for Continued Employment of Older Workers (1982).

TABLE 7. LONG-RUN SAVINGS RELATIVE TO CURRENT LAW OF SEVERAL OPTIONS TO DELAY RETIREMENT (As a percentage of taxable payroll)

Option	Total, 1982- 2056	Twenty-five-year Periods		
		1982- 2006	2007- 2031	2032- 2056
Increase Delayed Retirement Credits ^a	-0.15	-0.05	-0.16	-0.23
Reduce Benefits for Early Retirees ^b	0.71	c	c	c
Raise Age of Eligibility for Full Benefits to 68 and Reduced Benefits to 65 ^d	1.03	0.12	1.41	1.55
Raise Age of Eligibility for Full Benefits to 68, Without Increase in Eligibility Age for Reduced Benefits ^e	1.17	0.21	1.40	1.89

SOURCE: Estimates provided by the Office of the Actuary, Social Security Administration. Negative numbers indicate costs.

- a. Increase in Delayed Retirement Credit to actuarially fair equivalent.
- b. The Administration's May 1981 proposal to reduce benefits at age 62 to 55 percent of full benefits.
- c. Twenty-five-year estimates of savings not available.
- d. Based on the proposal of the 1981 National Commission on Social Security, which would allow early retirement benefits at age 65 of 80 percent of the age 68 benefit. Proposal would also index earnings to age 63 rather than to age 60 as under current law. Savings would be larger by about 0.3 percent of long-run payroll if earnings were indexed only to age 60.
- e. Based on H.R. 3207 introduced by Congressman Pickle, which raises age for full benefits to 68 and increases the reduction for age 62 benefits to 36 percent from 20 percent.

a 12-year period ending in 2012, as proposed by the 1981 National Commission on Social Security, would reduce the 75-year deficit by an estimated 1.0 percent of payroll.⁷ The Commission's proposal would also involve indexing earnings for the computation of AIMEs up to age 63, rather than to age 60 as under current law. If the retirement age was increased as under that proposal, but earnings were indexed only to age 60, the 75-year cost savings would be larger by about 0.3 percent of payroll.

If the age of eligibility for full benefits was raised to 68, but early retirement benefits were still available at 62, benefits received by those retiring before age 65 would have to be reduced in order to maintain the cost savings. Under H.R. 3207, for example, which was introduced by Congressman Pickle, benefits at age 62 would be reduced to 64 percent of the full benefits, rather than 80 percent as under current law. Long-run savings under H.R. 3207 would actually be slightly larger than under the commission's proposal, since earnings would be indexed only to age 60 as under current law, rather than to age 63 as under the proposal.

The arguments for and the potentially adverse consequences of an increase in the age of eligibility for retirement benefits for some older workers are discussed below. To some extent, adverse consequences could be mitigated either through adjustments in existing programs or through the creation of new public programs. For example, the definition of disability under DI and SSI could be liberalized for older workers, to give greater weight to vocational factors. This would allow older workers with health problems sufficiently serious to affect their ability to work in their accustomed occupations to receive some disability benefits, which would to some extent offset the reductions in retirement benefits. Such a proposal would reduce long run cost savings from this option, however.

Retention of age 62 as the early retirement age, but with a greater benefit reduction factor, would also lessen the impact on such workers of an increase in the age of eligibility for full retirement benefits. This option would not necessarily reduce long-run savings resulting from delaying the age of eligibility for full retirement benefits, since total savings would depend upon how much early retirement benefits were reduced. If a reduction factor was chosen that would make age 62 benefits actuarially equivalent to those received at age 68, however, benefits for those retiring at 62 would be reduced to 64 percent of the full retirement benefit.

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7. For further details on this specific proposal, see National Commission on Social Security, Social Security in America's Future, the final report (March 1981), chap. 5.

PROS AND CONS OF INCREASING THE RETIREMENT AGE

To assess the merits of increasing the age of retirement, different factors must be taken into account. These include health, employment opportunities, and available retirement income.

Health Factors

Some view an increase in the retirement age as a logical response to the major health improvements that have occurred since the beginning of the Social Security program and that are expected to continue. They argue that it is unrealistic to continue a policy that encourages workers to spend all of their increase in expected lifetime in retirement. In this view health improvements, as measured by life expectancy, result in older persons who are healthier than those in earlier generations, and therefore more able to continue active work.

Increases in life expectancy affect the retired worker population for Social Security by increasing both the proportion of successive generations that attain age 65 and the average number of years over which benefits are received. Since the program first paid benefits in 1940, expected lifetimes of individuals have lengthened considerably. For men aged 65, the increase in expected lifetime since 1940 has been 2.2 years or about 18 percent. Increases for women have been even larger--5.1 years or about 38 percent.⁸

These improvements in life expectancies are projected to continue. The average life expectancy of men aged 65 is projected to increase an additional 10.5 percent by the year 2000, and that of women almost 13 percent over the same period. On the basis of these figures, an increase in the retirement age to 68 in the year 2000 would leave male workers with 0.7 more years of retirement benefits than their 1940 counterparts and 1.5 fewer years than those retiring at age 65 in 1980. For women the figures would be 4.5 and 0.6, respectively.⁹

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8. In 1940, average life expectancies at age 65 were 12.1 years for men and 13.6 years for women. U.S. Department of Health and Human Services, Social Security Administration, Office of the Actuary, Social Security Area Population Projections, 1981, Actuarial Study no. 85 (July 1981).
 9. These calculations assume that the same proportion of future retirees will retire early as now do. Under the intermediate mortality assumptions of the 1982 Social Security Trustees' Report, men would

These figures obscure substantial differences in life expectancies between different population subgroups. There is evidence that workers in different occupations have systematically different life expectancies, for example, and that those engaged in less arduous employment live longer than those in more strenuous jobs.¹⁰ Moreover, a recent study of Social Security retirees found that men accepting benefits before age 65 had significantly higher mortality rates than those who postponed retirement to age 65 or later.¹¹ Consequently, an increase in the retirement age could reduce the proportion of workers that live long enough to receive benefits, and therefore could have more of an impact on some groups of workers than on others.

Further, measures of health status other than life expectancies indicate that the ability of older Americans to work may not have improved, or may even have declined slightly over the last decade. Indeed, improvements in life expectancies may partly reflect longer survival periods for those with serious or chronic health problems. A comparison of Health Interview Survey data indicates that in 1980 higher proportions of men in the 60-64 and 65-69 age groups reported being unable to work due to chronic health conditions than in 1970.¹² While these data may reflect many factors other than actual health status, such as changing health expectations, changing life styles, and other problems associated with self-reporting, they lead one to question the assertion that, on average, the health of older workers has improved.

On the other hand, a recent study by the General Accounting Office (GAO) indicates that the proportion of early retirees reporting ill health as their principal reason for retirement has declined considerably over the last decade. According to the GAO study, about 19 percent of early retirees reported that they retired because of poor health, as compared with 54

not regain their 1980 position until 2050, whereas women could expect the same number of retirement years beginning between 2010 and 2020.

10. Robert M. Butler, Statement before the National Commission on Social Security Reform, June 21, 1982.
11. John R. Wolfe, "Perceived Longevity and Early Retirement," Econometrics Workshop Paper no. 8105, Michigan State University (May 1982).
12. Jacob Feldman, "Work Ability of the Aged Under Conditions of Improving Mortality," Statement before the National Commission on Social Security Reform, June 21, 1982, p. 17.

percent in a Social Security Administration study of workers retiring in 1968 through 1970.¹³ This decline may be partially attributable to the expansion of the Disability Insurance program during the 1970s since a larger proportion of those aged 62-64 who are in poor health may now be receiving DI benefits. Since 1977, however, awards for DI benefits have been declining, which may lead to future increases in early retirements because of poor health. In addition, the proportion of workers retiring early increased substantially over this decade, so even if workers' health status has not improved, the proportion retiring early because of ill health would have declined as early retirement for other reasons increased.

If an increase in the age of eligibility for retirement benefits was legislated, presumably some of those who suffered from ill health would become eligible for disability benefits, thereby offsetting some of the reduction in outlays for retirement benefits. The availability of disability benefits for at least some older workers in poor health would also help to mitigate the adverse affects of an increase in the retirement age for this group.

Employment Factors

Arguments for an increased retirement age also assume changes in certain characteristics of future retirees, such as educational attainment. The proportion of the population attending college has grown steadily in recent years, suggesting that this may delay entry into the labor force and shorten working lives. In conjunction with the trend toward less physically demanding jobs, this has led some to argue that a higher proportion of later generations will be able to continue working past age 65.

The trend to college education has not included all workers, however. Almost one-quarter of the work force still lacks high school diplomas, and even among younger workers (those 25-29), about 15 percent have not graduated from high school.¹⁴ Employment opportunities for workers with

13. General Accounting Office, Demographic and Economic Characteristics of Social Security Retiree Families, HRD-82-131 (September 28, 1982). Social Security Administration, Reaching Retirement Age, Research Report no. 47 (1976).

14. A proposal that would mitigate the effects of an increase in the retirement age for those who start work at an early age would be to base eligibility for benefits on either a minimum number of years worked or the attainment of a minimum age.

little education or low skill levels tend to be in relatively more arduous occupations than for those with higher educational attainment. Many of these workers could have difficulty continuing to work past 65, therefore, especially if the changes in the occupational mix and skill requirements of the labor force reduce the relative number of unskilled and semiskilled jobs over time. In addition, even though the average number of years of schooling has increased for the labor force as a whole, there is no evidence that this has decreased labor force participation rates for young people.¹⁵

On the other hand, demographic factors may facilitate the absorption of increased numbers of older workers into the labor force in the future. The population aged 20 to 64 is projected to decline as a proportion of the total population after 2010. This demographic shift may cause the demand for older workers to increase as employers find younger workers increasingly scarce. This could cause wage rates for older workers to rise, which would also encourage many of them to continue working to a later age.¹⁶

Retirement Income Factors

For many, income is a critical factor in determining whether to continue working. An increase in the age of eligibility for Social Security retirement benefits or a substantial reduction in early retirement benefits would cause such persons to delay retirement. It would also reduce lifetime Social Security benefits, which some economists believe would induce people to work and save more in order to offset the decline in their expected retirement incomes.¹⁷

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15. Labor force participation rates have in fact increased slightly for men 16-19 years old over the last 20 years, and are about the same level as they were 20 years ago for men 20-24 years old. For women, labor force participation rates have increased significantly in both age categories. See Bureau of Labor Statistics, Handbook of Labor Statistics (December 1980), Table 4, p. 13.
 16. Younger workers could also be affected by an increase in the retirement age. The retention by employers of older workers would diminish the opportunities for promotion of younger employees.
 17. See Martin Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," Journal of Political Economy, vol. 82, no. 5 (September/October 1974), pp. 905-26.

The impact of Social Security changes designed to encourage later retirement would also depend in part on the responses of private pension plans. Many private pension plans now allow workers to receive benefits at earlier ages than does Social Security, and the trend has been toward even lower eligibility ages.¹⁸ Since eligibility for pension benefits is expected to increase considerably in the future, the trend toward lower eligibility ages might work against changes in Social Security rewarding later retirement. If it did, however, it could require major increases in funding for pension benefits. The reason is that many plans have benefit formulas that pay one level of benefits before a worker is eligible for Social Security and a lower level after eligibility, so that an increase in the Social Security retirement age would increase the liabilities for this type of pension fund. The prospect of these increased costs might cause pension plans to reverse the recent trend and delay eligibility ages in a way corresponding to the modifications made in Social Security. If this occurred, the increasing availability of pension benefits would be less likely to offset the effects of an increase in the retirement age.

Workers nearing retirement age in the future may increasingly have access to other sources of retirement income. Recent tax law changes provide substantial incentives for people to save through Individual Retirement Accounts (IRAs) and Keogh plans. While it is still too early to access the impact of these new incentives, some increase in retirement savings through IRAs and Keoghs is likely. Expanded access to this type of investment income in the next century could partially offset the effects of changes in Social Security intended to encourage later retirement.

18. For a survey of the plans for 240 large corporations, see Bankers Trust Company, Corporate Pension Plan Survey (1980).

CHAPTER VI. ADJUSTING BENEFITS FOR COST-OF-LIVING CHANGES

As recent experience has shown, Social Security balances can fall rapidly in periods when wages rise more slowly than prices. To some extent, this problem results from the fact that trust fund revenues are based on wages, while benefit levels rise with prices because they are adjusted each year to reflect changes in the cost of living. One way to decrease the sensitivity of trust fund balances to economic performance would be to modify the procedure used to adjust benefit levels, so that benefits would not rise faster than wages even in periods of slow wage growth. This chapter outlines several such proposals to change cost-of-living adjustments (COLAs) to provide more stable trust fund balances.

Reductions in cost-of-living adjustments have also been suggested as a partial solution to the short-run financing problem, and they could indeed produce substantial short-run savings (see Appendix C). If benefits were increased by much less than the increase in prices over a long period of time, however, their purchasing power could decline substantially. Further, reductions in COLAs would have a cumulative effect over time, and if maintained over an extended period would cause the purchasing power of benefits to decline further in each year of retirement. Thus, COLA reductions implemented over extended periods could substantially increase poverty rates for older recipients. In addition, both health status and employment opportunities tend to decline with age, making it more difficult for very old recipients to adjust to large declines in their real incomes.

For these reasons, COLA reductions, as distinct from indexing changes designed to promote the financial stability of the trust funds, are not generally proposed as a means of generating long-run cost savings. This chapter concentrates instead on options primarily aimed at decreasing the volatility of trust fund balances. The next section provides some background information on benefit indexation and its effects on the trust funds, and the final section examines options to stabilize trust fund balances over the long run.

AUTOMATIC BENEFIT ADJUSTMENTS: HISTORY AND EFFECTS ON TRUST FUND STABILITY

Automatic indexing of Social Security benefits was legislated as part of the 1972 Social Security amendments, although various indexing schemes

had been proposed before that.¹ Somewhat ironically, a major impetus for the plan was that it was expected to help restrain the growth of benefits. In the seven years preceding the passage of the 1972 amendments, benefits had been raised three times--by 13 percent, 15 percent, and 10 percent--resulting in a cumulative increase of 43 percent between February 1965 and January 1971, over the same period the Consumer Price Index had risen only 27 percent. For this reason many legislators believed that linking benefit increases to the CPI would help keep down Social Security costs. Under the 1972 amendments, the first automatic cost-of-living adjustments became payable with the June 1975 benefits, although an additional benefit increase of 20 percent was also given in September 1972.

The methodology for computing Social Security benefits has not changed since 1975. Under current law, Social Security benefits are indexed to increases in the Consumer Price Index for urban wage earners and clerical workers (CPI-W). The COLA is determined by dividing the average CPI in the first calendar quarter of one year by the corresponding CPI for the previous year. If the increase is more than 3 percent, benefits are adjusted, starting with the payment received in July, to reflect the rise in the CPI.²

The purpose of this method of adjusting benefits is to maintain the purchasing power of benefits over time. If benefits were not adjusted as prices rose, their purchasing power would erode and the adequacy of retirement benefits would decline as beneficiaries got older. Because of these adjustments, however, outlays rise as prices go up. Revenues will not necessarily increase by the same amount, since most trust fund income comes from the payroll tax, which is a proportional tax on wages. Prices may rise even in periods of slow wage growth. In periods of slow wage growth, prices may rise faster than wages, causing increases in outlays to exceed increases in revenues, as in 1979-1981. If price increases exceed wage growth over an extended period, total outlays may exceed total revenues, causing trust fund reserves to deteriorate.

Extended periods of slow wage growth can threaten the solvency of the trust funds even in periods when the ratio of wage earners to beneficiaries is relatively high. If no major benefit reductions or tax

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1. For a discussion of efforts to index benefits, see Indexation of Federal Programs, prepared by the Congressional Research Service for the Senate Committee on the Budget, 97 Cong. 1 sess. (May 1981).
 2. If the CPI increase is less than 3 percent, then the next year's COLA is based on the price increase over the two-year period.

increases are enacted, for example, and another period comparable to the recent past occurs in the late 1980s or early 1990s, the trust funds could face another financing crisis in spite of the relatively favorable demographic conditions projected for that period.

The estimates presented in this paper assume that the economy will reach long-term trend levels of growth in key variables within the next ten years, and maintain those levels indefinitely. In practice, however, while the economy may on average achieve the assumed rates of growth, its actual year-to-year behavior is likely to continue to vary in a cyclical manner. Such cycles are not built into the assumptions because their occurrence is very difficult to predict, and over the long run the average rate of growth is a more important determinant of trust fund solvency than the variation around that average. Under current law, however, until the trust funds accumulate large reserves, they will continue to be vulnerable to serious financing problems in periods when prices grow rapidly relative to wages.

POLICY OPTIONS

Options intended to increase trust fund stability generally involve linking benefit increases to a measure that will not rise faster than wages, so outlays cannot increase more rapidly than revenues.³ This section examines three options that would link benefit levels to revenue levels through some form of wage-indexing.

Substitution of a Wage Index

The simplest way to prevent benefit increases from exceeding wage increases would be to base adjustments on a wage index rather than on the CPI. Use of a wage index would maintain the relationship between the incomes received by workers and the level of benefits regardless of changes in prices. Since revenues and benefits would both be linked to wages, such an index would also prevent benefits from rising faster than revenues during periods of poor economic performance.

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3. An alternative would be to stop indexing benefits and return to a system of discretionary benefit adjustments, or a system that required an annual vote on benefit increases, which would allow greater flexibility. Before benefit indexing began, however, such discretionary adjustments generally exceeded price increases.

Over the long run, however, productivity increases have made it possible for wage growth to exceed growth in prices, and such a pattern is expected to hold again in the future. In that case, the long-run costs of wage-indexing benefits would exceed the costs of price-indexing. Under the Alternative II-B assumptions, long-run real wage growth is assumed to be 1.5 percent per year, which would result in additional outlays over the next 75 years of about 2.3 percent of long-run payroll if benefits were wage-indexed rather than price-indexed (see Table 8). In addition, the purchasing power of benefits would fluctuate more than under the present system and, in periods of poor economic performance, the value of benefits could decrease substantially.

Indexing by a Reduced Wage Index

In order to provide the stable trust fund balances that would result from linking both income and outlays to wage growth, without the long-run cost increases that could be expected if benefits were simply indexed by wages, some analysts have proposed using a wage index that has been adjusted downward by the expected long-run differential between wages and prices--1.5 percent, under the Alternative II-B assumptions.⁴ Under this proposal, growth in benefits would equal growth in prices over the long run if the real wage increases projected by the Social Security Administration were achieved.

In addition to stabilizing balances, this proposal would keep benefit increases proportional to increases in wages. Periods of low and negative real wage growth impose hardships on workers, and some have argued that those burdens should be shared by retirees. Cost-of-living adjustments for Social Security recipients would be limited in periods of low wage growth, without the increases in Social Security costs that would result from simple wage-indexing.

4. This is one of the options proposed by the staff of the National Commission on Social Security Reform. The technical aspects of the proposal are still being developed, and the specific percentage by which wages would be reduced to determine annual benefit increases would depend upon the choice of the wage measure. Under the Alternative II-B assumptions, if an hourly earnings index was chosen, the growth rate that would produce no long-run effect on the trust funds would be 1.8 percent rather than 1.5 percent because such an index would rise more rapidly than an annual wage index.

TABLE 8. LONG-RUN SAVINGS OF SEVERAL INDEXING OPTIONS, RELATIVE TO CURRENT LAW (As a percentage of taxable payroll)

Option	Total 1982- 2056	Twenty-five-year Periods		
		1982- 2006	2007- 2031	2032- 2056
Substitution of an Alternative Price Index for the CPI	0	0	0	0
Substitution of a Wage Index for the CPI ^a	-2.3	b	b	b
Indexing by Wage Increases Minus 1.5 Percent				
If implemented immediately	0.09	0.24	0.01	0
If implemented after 1990	0	0	0	0
Indexing by the Lower of Wage or Price Increases ^c	0.43	0.16	0.48	0.65

SOURCE: Estimates provided by the Office of the Actuary, Social Security Administration, based on the Alternative II-B assumptions of the 1982 OASDI Trustees Report.

- a. Minus signs denote cost.
- b. Estimates not available on a 25-year basis.
- c. This assumes no "catch-up" provision. A catch-up provision could be enacted to allow benefit increases to exceed price increases during periods of economic recovery, until benefit levels were as high as they would have been under current law. See text for discussion.

On the other hand, more stable trust fund balances would be achieved at the cost of greater fluctuations in benefit levels relative to the cost of living. If wage increases did not exceed price increases by at least 1.5 percent, real benefits would fall. Periods of low or negative real wage growth, like the recent past, would result in substantial real benefit declines. If this proposal had been in effect since 1975, for example, benefit levels would now be about 13 percent lower than under current law. Thus, under this proposal, the risks of poor economic performance would be shifted from the trust funds to beneficiaries.

Indexing by the Lower of Wage or Price Increases

Another alternative to stabilize trust fund balances would be indexing by the lower of wage or price increases. This option would restrict the growth of benefits in periods when prices are growing faster than wages, but would not cause long-run Social Security costs to rise. On the other hand, benefits could decline substantially under this option, both in real terms and in relation to earnings. If periods of real wage growth alternated with periods when increases in prices exceeded those in wages, as in the recent past, benefit increases would not keep up with either prices or wages.

In addition, an index based on the lower of wage or price increases would affect the degree to which Social Security benefits would replace wages lost as a result of an insured worker's retirement, disability, or death. Stabilizing these replacement rates was the guiding principle behind the indexing procedures enacted with the 1977 amendments. For workers retiring at age 65, indexing by the lower of wages or prices would result in lower replacement rates for some retirement cohorts than for others. This difference would depend upon the relationship between wage and price growth between the retiree's sixty-second and sixty-fifth birthdays. Since benefits are initially computed based upon eligibility at age 62 and price-indexed thereafter, an experience similar to 1978-1981 would lower replacement rates as compared to current law by 8 percent for certain retirees.

A "catch-up" provision could also be enacted, allowing, for example, benefit increases that exceeded price increases when the economy was coming out of a recession, until benefit levels were as high as they would have been under price-indexing. Such a provision would avoid large long-term declines in benefit levels, although temporary fluctuations in the purchasing power of benefits would still occur.

There would be little long-run savings if a catch-up was provided, however, and it could have very different effects on those retiring in different years. For example, some proportion of those whose benefits were

reduced during an economic downturn would die before their losses were caught up. In addition, retirees coming onto the system at the beginning of a catch-up period would receive windfall gains, since they would get catch-up increases but would never have experienced any benefit reductions. In order to avoid these overpayments, it would be necessary to compute separate adjustments for those who retired in each different year, which could prove to be an administratively difficult task.

CHAPTER VII. INCREASING TRUST FUND REVENUES

So far, this paper has focused on ways to improve the long-run financial status of the Social Security trust funds by reducing projected Social Security outlays. A second approach to improving trust fund balances would be to increase revenues, either as an alternative or as a supplement to reducing outlays. This chapter briefly describes the sources of Social Security revenues, and then discusses several options for increasing them.¹

REVENUE SOURCES FOR SOCIAL SECURITY

Almost 98 percent of OASDI revenues in 1981 came from the payroll tax. Increases in the tax rate are scheduled for 1985 and 1990 under current law (see Table 9).

Current Social Security revenues finance current benefits, notwithstanding the fact that workers' entitlements to future Social Security benefits are based on the earnings on which their contributions are assessed. Any excesses of revenues over outlays are accumulated by the trust funds as reserves, and are held in the form of Treasury bonds upon which the trust funds receive interest. Interest payments in 1981 accounted for more than two-thirds of the remaining 2.2 percent of revenues.² When outlays exceed income, trust fund reserves are drawn upon to pay benefits.

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1. This chapter assumes that the combined OASDI tax revenues will be allocated between the OASI and DI trust funds so as to meet the obligations of the individual trust funds. Under the Alternative II-B assumptions, the revenues allocated to the OASI fund under current law will not allow it to meet all benefit payments, while the DI fund will build up enormous reserves. The following discussion assumes the Congress will enact, at a minimum, a reallocation of tax rates or an extension of interfund borrowing authority between the OASI and DI funds. Further, the possibility of borrowing from the HI fund is not considered here as an option for the long run because the HI fund is projected to have depleted its reserves by the late 1980s or early 1990s.
 2. In addition to payroll tax receipts and interest payments, the OASDHI trust funds also receive a small amount of income from general

TABLE 9. PAYROLL TAX RATES UNDER CURRENT LAW, 1982-1990

	Combined Employer- Employee Taxes OASDI	Employers and Employees, Each		
		OASDI	OASI	DI
1982-1984	10.8	5.4	4.575	0.825
1985-1989	11.4	5.7	4.75	0.95
1990 and Thereafter	12.4	6.2	5.1	1.1
		Self-employed		
		OASDI	OASI	DI
1982-1984	---	8.05	6.8125	1.2375
1985-1989	---	8.55	7.125	1.425
1990 and Thereafter	---	9.3	7.65	1.65

SOURCE: Social Security Bulletin, Annual Statistical Supplement, 1980, p. 35.

NOTE: Payroll tax rates for Hospital Insurance are 1.3 percent in 1982-1984, 1.35 percent in 1985, and 1.45 percent beginning in 1986. Employers, employees, and the self-employed each pay the same rate.

revenue transfers. These transfers, which provided about \$843 million in 1981, or less than 1 percent of income, cover the cost of noncontributory credits for military service and certain very limited types of benefits not based on earnings records, such as the special age 72 benefit received by persons 72 or older who do not qualify for retired worker, spouse, or survivor benefits.