About 90 percent of all workers now hold jobs covered by Social Security. The major exceptions are federal civilian employees and the employees of some state and local governments and nonprofit organizations.[3] For those who are covered, payroll taxes are paid by both employers and employees on wages up to an amount known as the "maximum taxable wage." This amount is increased every year to reflect general wage growth, and in 1982 is $32,400.

POLICY OPTIONS

Options for increasing Social Security revenues fall into four general categories: those that would change the payroll tax rate and earnings base, those that would extend Social Security coverage to workers not now covered, those that would introduce additional sources of tax revenues, and those that would involve transfers from general revenues. All four types are considered in this section. In addition, revenue-side options to enhance the stability of trust fund balances are considered at the end of the chapter.

Payroll Tax Increases

In general, payroll tax increases would mitigate the financial problems of the trust funds while protecting beneficiaries from substantial benefit cuts. In addition, increasing Social Security revenues through increases in payroll taxes would maintain the traditional financing structure of the trust funds. If implemented in the near future, however, payroll tax increases would increase tax burdens on workers at a time when their earnings have been declining relative to benefits, as a result of the price indexing of benefits and the recent declines in real wages. Moreover, the payroll tax, which is a relatively regressive tax, already accounts for an increasing share of total federal revenues; further rate increases would cause its share to grow even faster.[4]

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3. Uniformed military personnel are covered by Social Security. Participation in Social Security is voluntary for state and local governments and nonprofit organizations. Approximately 70 percent of state and local government employees and about 80 percent of employees of nonprofit organizations are now covered by Social Security.

4. The payroll tax for OASI and DI is projected to grow from 22 percent of total federal revenues in 1980 to 25 percent in 1985. If HI payroll tax receipts are included, the projected growth is from 26 percent in 1980 to 31 percent in 1985.

Specific options to increase payroll tax revenues involve either increasing the payroll tax rate or expanding the taxable wage base. One proposed option would be to move the tax increases scheduled for 1985 and 1990 forward to 1984. This would increase long-run revenues by only 0.1 percent of long-run payroll, however.[5]

Alternatively, payroll tax rate increases in addition to those scheduled for 1985 and 1990 could be made after 2010, when outlays are expected to increase substantially. If the entire projected deficit were to be closed through payroll tax rate increases, the combined employer-employee rate would have to be raised from 12.4 percent to about 17 percent in 2035.[6] Alternatively, to achieve about the same reduction in the 75-year deficit as under the options to reduce the formula bend points or to raise the retirement age discussed in Chapters IV and V, payroll tax rates could be increased to 13.5 percent in 2020 and 14.6 percent in 2030. This is one of a number of possible schedules of payroll tax rate increases that would eliminate about one-half of the long-range shortfall in the trust funds.

A general payroll tax increase of this type would reduce the need for benefit reductions to keep the system financially solvent, and would avoid building up much larger reserves than needed in earlier periods if it was not implemented until 2020. It would, however, increase payroll tax rates by two percentage points--a tax increase of almost 18 percent. Such an increase would raise the price of labor and could cause employers to substitute capital for labor where possible, thus reducing employment opportunities. In addition, it could reduce work incentives by lowering net wages.[7]

Additional payroll tax revenues could also be generated by increasing the maximum earnings subject to the payroll tax more than under current law. The maximum taxable wage is $32,400 in 1982, and is currently scheduled to increase each year by the increase in average earnings.

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5. In the short run, however, the impact would be substantial. See Appendix C.

6. Under the pessimistic (Alternative III) assumptions used in the Trustees' Report, the rates would have to be as high as 23.9 percent in 2035 and 28.5 percent in 2060.

7. In general, economists agree that the employees' share of the payroll tax is primarily borne by wage earners. The employers' share, however, may be borne by owners of businesses, or may be shifted to employees in the form of reduced wages or to consumers in the form of higher prices.

Approximately 90 percent of all wages in employment covered by Social Security fall below the maximum earnings limit. If employers were required to pay OASDI taxes on their entire payrolls, as proposed by the Carter Administration in 1977, the projected 75-year deficit would be reduced by about 0.6 percent of taxable payroll.

Eliminating the maximum taxable wage for both employers and employees would improve projected trust fund balances by about 0.8 percent of taxable payroll. The resulting increased receipts would be partially offset by higher future benefits for those with earnings above the current law maximum. The trust funds would experience a net gain, however, because benefits replace a smaller proportion of earnings as average earnings levels rise. Expanding the Social Security tax base by increasing the maximum taxable wage would provide substantial revenue increases, therefore, without directly increasing the tax burden for most workers.[8]

Either of these options would increase the relative tax burden for high-wage earners, however, who already receive a relatively low rate of return on their contributions because of the progressivity of the benefit formula.[9] These options could also encourage employers of high-wage workers to shift a greater proportion of their compensation into untaxed fringe benefits, which would reduce revenue gains.

Extensions of Coverage

One of the most commonly recommended changes would be to extend coverage to some or all of those who are not now covered.[10] If the

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8. Workers would be indirectly affected, however, if the burden of payroll tax increases was shifted to consumers through price increases.

9. The option of increasing the maximum for employers only would only affect high-wage earners if employers were able to shift at least some of its costs to employees through lower net wages.

10. Expansions in coverage were recommended by the 1975 and 1979 Advisory Councils on Social Security, the President's Commission on Pension Policy, and the 1981 National Commission on Social Security. For a comprehensive analysis of the implications of universal coverage, see The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State, and Local Governments and Private Nonprofit Organizations, Report of the Universal Social Security Coverage Study Group, March 1980.

extension of Social Security coverage was limited to new federal employees, new revenues of about 0.3 percent of taxable payroll would be added to the trust fund (see Table 10). This could divert revenues from the Civil Service Retirement fund, however. If all future new employees in jobs not now covered were brought into the Social Security system, its deficit would fall by about 0.5 percent of taxable payroll. If coverage was made mandatory for all current employees in noncovered occupations, as well as for new employees, the net impact would be virtually the same, largely because this extension of coverage would entail increased future benefit payments as well as increased revenues.

Social Security coverage would provide noncovered workers certain benefits that are unavailable from most employers, such as earnings credits regardless of job changes, automatic indexation of past earnings to reflect overall wage growth, tax-exempt treatment of benefits, and benefits for other family members such as spouses and children. These advantages would be offset for some workers by certain disadvantages, however, since many workers in currently noncovered employment have benefits with standards that are less strict than Social Security, such as disability insurance, and are eligible for early retirement before age 62. In addition, some employees in noncovered jobs--for example, civil service workers--are eligible for retirement benefits after a certain age and number of years of service even if they continue to work for other employers than the one providing the pension.

Extending coverage to government employees would also create some administrative problems. Immediate coverage of all current and future federal employees would require integrating Social Security with the Civil Service Retirement System (CSRS), another program that relies heavily on current contributions to fund current benefits. Covering only new federal employees under Social Security and restructuring CSRS to supplement Social Security--as is done with private employer pensions--would facilitate a smooth transition while having the same net impact on the OASDI trust fund deficit over the long run.[11] Mandatory coverage of state and local government employees could encounter constitutional challenges, because under the Constitution the federal government cannot directly tax state and

11. For examples of how this restructuring could be accomplished and an analysis of its implications for the federal budget, see Congressional Research Service, Restructuring the Civil Service Retirement System: Analysis of Options to Control Costs and Maintain Retirement Income Security (1982). Also see Sylvester J. Schieber, "The Cost and Funding Implications of Modifying the Civil Service Retirement System" (Washington, D.C.: Employee Benefit Research Institute, August 1982).

TABLE 10. LONG-RUN REVENUE INCREASES RELATIVE TO CURRENT LAW UNDER SEVERAL OPTIONS (As a percentage of taxable payroll)

Option	Total, 1982-2056	Twenty-five-year Periods 1982-2006	2007-2031	2032-2056
Payroll Tax Increases				
Move forward 1985, 1986, and 1990 payroll tax increases to 1984	0.09	0.27	0	0
Increase payroll tax rates by 1.1 percent in 2020 and again in 2030[a]	0.94	0	0.62	2.20
Extend coverage to new employees[b]				
Federal workers	0.28	0.21	0.41	0.21
All workers	0.53	0.45	0.76	0.38
Eliminate maximum taxable wage				
Employers only	0.57	0.44	0.58	0.69
Employers and employees	0.83	0.96	0.86	0.67
Other Tax Increases				
Tax one-half of OASI benefits[bc]	0.50	d	d	d

SOURCE: Estimates provided by the Office of the Actuary, Social Security Administration.

a. This would increase OASDI rates to 6.75 percent each for employers and employees in 2020, and 7.30 percent each in 2030.

b. Assumes implementation in 1984.

c. If DI benefits were included, the estimated revenue increase would be 0.6 percent of taxable payroll. Estimate is preliminary and subject to revision.

d. Estimate is not available for 25-year periods.

local governments, and some believe that the imposition of the employers' share of the payroll tax on these jurisdictions would constitute such a tax.

On the other hand, mandating Social Security coverage for federal, state, and local employees would eliminate the windfall gains some now experience by working in covered employment for just long enough after retirement from their noncovered government jobs to qualify for Social Security.[12] Retired government employees generally receive a higher rate of return on their Social Security contributions than other workers with comparable annual earnings. This is because Social Security benefits are higher relative to contributions for those with low lifetime earnings, and retired government employees generally have low AIMEs because of their limited time in covered employment.

Increases in Other Taxes

A third type of option for increasing OASDI revenues would be to generate new tax revenues for the trust funds from sources other than the payroll tax. This option would maintain the trust funds as separate entities within the budget, with their own dedicated revenues, although these revenues would no longer be tied exclusively to wages. It would thus reduce the dependence of current benefits on current wages, although presumably workers' future benefit entitlements would continue to be based on their own earnings records. When the "baby boom" generation begins to retire, and the number of beneficiaries grows relative to the number of workers, some revenue source for the trust funds that is not directly dependent on the size of the wage bill may be desirable.

Among options for earmarking additional taxes for OASDI, one that has been frequently proposed is the taxation of all or some portion of Social Security benefits, with the proceeds to be allocated to the trust funds. Employees have already paid income taxes on the contributions they have made to Social Security, but most beneficiaries now receive benefits far in excess of their own contributions. Social Security benefits could be taxed in the same way as private pensions, with no tax being paid until employees have received back their total contributions, and with benefits becoming fully taxable thereafter.[13] Alternatively, for simplicity's sake, beneficiaries

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12. As of 1975, approximately 70 percent of CSRS annuitants either received or were expected to receive Social Security retired-worker benefits, for example.

13. Tax treatment fully comparable to that accorded private pensions would include taxation of accumulated interest on both employee and

could pay taxes on half their benefits, on the theory that half the contributions made in their behalf--those made by their employers--have never been taxed. Most low-income beneficiaries would not be affected under this proposal, since they would still have incomes too low to make them liable for income taxes. Revenue increases could be large: for example, taxing half of OASI benefits could increase long-run revenues by about 0.5 percent of payroll. Further, this option would provide a revenue source linked to the size of benefit outlays, so that in periods when spending for benefits increased, tax revenues would also increase.

In order to provide further protection to low- and moderate-income beneficiaries, benefits could be taxed only for those with total incomes--including one-half of Social Security income--above some specified level. For example, Social Security benefits could receive tax treatment similar to Unemployment Insurance (UI) benefits. Under current law, the portion of UI benefits that, in combination with other income, results in total incomes above $12,000 for individuals and $18,000 for couples is subject to the income tax. The additional tax revenue generated under this option would depend on the minimum income level specified, with higher levels yielding less revenue.

One difficulty is that, if these proposals were implemented without a phase-in period, they would reduce benefits quite sharply and with very little warning for retirees with any substantial source of taxable retirement income. Those with earnings at or near the maximum are more likely than other workers to have such additional income, and this proposal would further reduce rates of return on contributions for such workers, which are already relatively low. Some analysts would therefore favor taxation of benefits only if it was combined with a benefit restructuring that reduced, rather than increased, the progressivity of the system.[14]

Other revenue-generating alternatives that have been proposed include the imposition of increased excise taxes on goods such as alcohol and tobacco, with the resulting revenues earmarked for the trust funds. Federal taxes on alcohol have not been increased since the mid-1950s, although prices have more than doubled over this period, and taxes as a percentage of prices have, therefore, fallen dramatically. Cigarette taxes were doubled

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employer contributions at the time benefits were paid. The Social Security Administration's Office of the Actuary estimates that comparable treatment would result in taxing about 83 percent of benefits for workers now starting to pay taxes.

14. One such proposal is the two-bracket formula suggested by the 1979 Social Security Advisory Council. See the Council's report, pp. 58-63.

this year, but the new revenues were not allocated to the trust funds.[15] Linking alcohol and tobacco taxes to the prices of the goods, rather than to volume as under current law, would cause revenues to keep pace with price increases. Those who favor this option point out that alcohol and tobacco are associated with considerable risks of injury and illness, and argue that persons who voluntarily incur these risks should also bear at least some of the resulting increase in program costs.

On the other hand, the effects of smoking and drinking cannot be linked directly, in most cases, to receipt of benefits. In fact, many people who paid these taxes might never receive benefits. Additionally, opponents argue that increasing taxation of alcohol and tobacco, and not all other products hazardous to health, would be arbitrary.

General Revenue Transfers

Finally, transfers of existing revenues from other parts of the budget to the trust funds constitute a fourth possible option for increasing trust fund revenues.[16] If benefit levels higher than what can be funded through current law trust fund revenues are deemed appropriate, and it is not considered necessary to provide the entire funding of Social Security through earmarked taxes, one possibility would be to transfer to the trust funds whatever is necessary to maintain benefit payments. This would solve the Social Security problem, but could place severe strains on the remainder of the budget. With given targets for the unified budget deficit, this option would mean large tax increases or benefit reductions in other areas of the budget. It would also undermine the concept of a self-financing trust fund for Social Security.

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15. An increase in excise taxes on cigarettes was included in the Tax Equity and Fiscal Responsibility Act of 1982.

16. An additional option for increasing trust fund revenues proposed by Senator Proxmire would be to restructure the investment policies of the trust funds in order to increase the interest income they receive. Reserves are now very low, however, so that even if a relatively large increase in yields was achieved, total interest income would increase very little. Over the longer run, it seems unlikely that the return on investments can be significantly improved because current high real interest rates are unlikely to continue.

A variation on this option would be to allow the trust funds to borrow from general revenues in order to meet benefit payments. In the absence of other measures to increase revenues or cut benefits, however, the projected long-run deficit in the OASDI funds would preclude any substantial repayment of such loans.

A second approach, proposed by the 1979 Advisory Council on Social Security, would be to fund Medicare outlays through some means other than a payroll tax, and to transfer part of the payroll tax now allocated to HI to the OASDI funds. Reallocating the entire HI tax to OASDI would yield additional OASDI revenues that would more than offset the trust fund's projected long-run deficit without requiring reductions in cash benefits. This approach, however, would necessitate funding HI through additional taxes or additional federal borrowing.

Stabilization Measures

The cyclical behavior of the economy can also cause problems for the trust funds. In Chapter VI, ways of determining benefit increases that would mitigate these problems were discussed. Other measures on the revenue side could also help reduce the volatility of trust fund balances. One possibility mentioned earlier in this chapter would be the provision of additional revenues from a tax not directly dependent on wages. Revenues from the taxation of benefits, for example, would rise as benefits rose, and would provide additional trust fund stability in periods when prices rose rapidly relative to wages. Similarly, revenues linked to prices, as through an excise tax, would grow in periods of high inflation. But the effects of options such as these would be limited as long as payroll taxes continued to be the major revenue source for the trust funds.

A second approach would be to allow general revenue transfers or borrowing on a countercyclical basis. One such suggestion, proposed by the Carter Administration, would involve transfers to the trust funds to replace lost payroll taxes when unemployment exceeded 6 percent. An alternative would be to allow transfers or borrowing by the trust funds when prices rose faster than wages, or the trust funds suffered from imbalances in income and outlays for other reasons. The 1981 National Commission on Social Security, for example, proposed that the trust funds be allowed to receive such transfers whenever combined OASDHI outlays exceeded 18 percent of taxable payroll. This proposal could presumably be modified to apply to the OASDI funds alone, with the funds becoming eligible to receive transfers when outlays exceeded, for example, 14 percent of taxable payroll.

Even with benefit cuts or increases in revenues as compared with current law, Social Security reserves are likely to be low in the next 15 years. Under these circumstances, as recent experience has shown, cyclical downturns in the economy can place severe strains on the funds. Allowing some form of general revenue transfers would provide a measure of insurance without shifting the burdens to beneficiaries, as benefit-side stabilization measures would do. On the other hand, while such transfers would presumably be more limited than those that would be necessary to solve the long-term financing problem completely, they would have many of the same drawbacks. In particular, they would impose strains on other areas of the budget, and could also be seen as contrary to the principle of self-financing for the trust funds.

CHAPTER VIII. IMPLICATIONS

So far, this paper has presented a number of different types of options for improving the financial condition of the Social Security system over the long run. Each type of option has been discussed in considerable detail, and the advantages and drawbacks of specific plans have been examined. But the relative effects of different generic approaches--that is, the trade-offs between them--have not yet been addressed. This chapter describes these trade-offs, outlining the relative effects of different types and combinations of options.

Options are compared in the three ways suggested in Chapter II: according to their financial impacts in relation to the projected deficit under current law; according to their timing in relation to the projected needs of the trust funds; and according to their relative effects on the incomes of different groups of beneficiaries and workers. Finally, the chapter considers some ways in which various options might be combined.

IMPACTS OF SELECTED OPTIONS ON THE LONG-RUN DEFICIT

Over the next 75 years, the Old Age and Survivors Insurance and Disability Insurance trust funds are projected to have an average deficit of about 13 percent of outlays, or about 1.82 percent of taxable payroll. The options presented in this paper would have varying effects on the average deficit. None of the options would of itself entirely solve the long-run financing problem. The effects of some of them are summarized in Table 11, which includes examples of each of the major types of benefit reduction and tax increase previously discussed.

The estimates shown in Table 11 are for specific options discussed in the paper. In most cases, greater or lesser impacts could be achieved by increasing or reducing the stringency of an option. For example, the formula bend points could be reduced more or less than under the proposal analyzed here. Similarly, the age of eligibility for full retirement benefits could be raised to 67 or 69, instead of 68, and the various tax proposals could be modified to produce more or less revenue. In general, where more than one version of an option has been widely discussed, an effort has been made to choose a fairly intermediate specification for purposes of analysis.

Most of the options examined here would provide average long-run savings or revenue increases of between 0.5 percent and 1 percent of

TABLE 11. LONG-RUN IMPACT OF SELECTED SOCIAL SECURITY 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
	Surplus or Deficit Under Current Law			
Projected OASDI Surplus or Deficit[a]	-1.82	0.64	-1.68	-4.41
	Savings from Benefit Reductions			
Formula Change				
Change in bend points[b]	0.90	0.26	1.09	1.36
Proportional reduction[c]	0.89	0.25	1.08	1.35
Increase in the Age of Retirement				
Increase in the reduction factor for early retirement[d]	0.71	e	e	e
Increase in the age of eligibility for benefits[f]	1.03	0.12	1.41	1.55
	Revenue from Tax Increases			
Increases in Payroll Tax Rates of 1.1 Percentage Points in 2020 and 2030[g]	0.94	0.00	0.62	2.20
Increase in Coverage				
New federal employees	0.28	0.21	0.41	0.21
All new noncovered workers	0.53	0.45	0.76	0.38
Taxation of One-Half of OASI Benefits[h]	0.50	e	e	e

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

a. Minus sign denotes deficit.

b. Proposal to index bend points by 75 percent of wage increases for 12 years, starting in 1984.

c. Proposal to reduce percentage of earnings replaced by benefits proportionally in each bracket of formula by about 8 percent over 12 years, beginning in 1984.

d. Administration's May 1981 proposal to reduce benefits for age 62 retirees from 80 percent to 55 percent of full benefits, effective immediately.

e. Twenty-five-year estimates for this option are not available.

f. 1981 National Commission proposal to raise eligibility age by 3 months per year for 12 years, beginning in 2001.

g. Proposal to increase payroll tax rates to 6.75 percent each for employees and employers in 2020, and to 7.30 percent in 2030. Payroll tax rates for the self-employed would be increased commensurately.

h. Estimate is preliminary and subject to revision. Savings are for implementation as of 1984; could also be phased in. If one-half of DI benefits were also taxed, total revenue increases would be 0.6 percent of taxable payroll.

taxable payroll, or about one-fourth to one-half of the long-run deficit under the Alternative II-B assumptions. To eliminate completely the estimated long-run deficit, two or more options of this size would have to be enacted. Another approach would be initially to enact an option or combination of options with a smaller total impact in order to lessen the risks associated with worse-than-projected economic and demographic conditions, with the expectation that additional action could be taken later if it proved to be necessary.

ISSUES OF TIMING

Timing issues are of two major types. The first has to do with the periods when changes in the ratio of workers to beneficiaries may be expected to cause trust fund shortfalls. The timing of trust fund needs, and of options to meet those needs, are discussed in the first two parts of this section. Another kind of timing problem arises from cyclical fluctuations in economic behavior. This problem, and options to stabilize trust fund balances over time, are discussed in the third part of this section.

Timing of Trust Fund Needs

Under the Alternative II-B assumptions, a large buildup in the trust funds is projected during the 20 years between 1995 and 2015, but these reserves are expected to be rapidly depleted as the baby boom generation begins to retire. No deficit is projected, on average, over the next 25 years, although under current law reserves are projected to be less than the amount needed to pay one month's benefits until 1994. Balances thereafter are projected to grow to a peak of about 180 percent of outlays in 2015. A rapid decline is projected over succeeding years until the trust funds become exhausted again sometime between 2025 and 2030.

The economic assumptions underlying this projection are crucial: that the economy will recover in 1982-1983 and will grow at a steady rate of about 3 percent a year over the next decade and about 2-1/2 percent thereafter. If instead the economy did not fully recover until 1984-1985, and then reached an ultimate growth rate of only about 2 percent a year, as under the more pessimistic Alternative III assumptions, Social Security costs would rise steadily as a percentage of taxable payroll until about 1990, when they would reach a plateau of just under 13 percent of payroll, or about 0.5 percentage points higher than trust fund income. They would remain at this level for about 15 years, and then start to rise rapidly again after 2005. Under this set of assumptions, no buildup in trust fund reserves would occur, since outlays would exceed revenues over the entire projection period.

Reductions in benefits or increases in revenues would be needed in the immediate future to maintain the long-run solvency of the system.

Even if economic growth did not prove to be as consistently low as under Alternative III, the trust funds could experience some financing problems in the 1990s and early 21st century if growth over the next 15 years was occasionally less than under the Alternative II-B assumptions, because even under those assumptions balances will be low until after 1995. For example, if another period like the last three years occurred in the mid 1990s, it could endanger trust fund solvency even if the economy had previously followed a growth path like that assumed in Alternative II-B.

Timing of Options

In choosing among options for the long run, therefore, the problems associated with large trust fund buildups must be balanced against the risks of worse-than-projected economic performance. Social Security has been designed as a pay-as-you-go system, and the accumulation of even larger reserves than already projected between 1995 and 2015 would constitute a change in the way the system is funded. In addition, the buildup of very large reserves in the Social Security trust funds could affect the rest of the budget and the economy. If the budget were to be balanced over the 1995 through 2015 periods, for example, the excesses of Social Security income over outlays during this period would mean, on a year-to-year basis, reductions in other taxes or increases in spending--a situation that would be abruptly reversed in the succeeding ten years.[1] In the past, furthermore, the buildup of large trust fund reserves has resulted in ad hoc benefit increases, so that some safeguards against such increases might be necessary if reserves were to be accumulated to offset future trust fund deficits. On the other hand, if the economy did not perform as well as projected under the Alternative II-B assumptions, the projected buildup of trust fund reserves might not occur.

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1. Social Security reserves are held in the form of securities issued by the U.S. Treasury. Thus, while Social Security taxes cannot be spent directly on other programs, additions to the reserves, in effect, take the place of other government borrowing, and in that sense provide additional resources to the budget as a whole. Conversely, the drawing-down of reserves removes resources from the unified budget, and will cause the budget deficit to rise over time unless other taxes or spending reductions are enacted to offset it.

The options discussed here differ considerably in the timing of their effects. Table 11 outlines these effects by 25-year periods. Most of the benefit-reduction options considered in this paper would be phased in gradually, so their major savings would occur 20 or more years from now. Some of the tax-increase options, such as the taxation of benefits or the acceleration of the payroll tax increases scheduled for 1985 and 1990, could be implemented almost immediately; others, such as Social Security coverage for new employees in currently noncovered jobs, would not produce substantial revenues for some years.

The option to increase payroll taxes discussed in Chapter VII and shown in Table 11 was designed to provide additional reserves to the system only as they become necessary under the Alternative II-B assumptions, and therefore would have no effect until 2020. If the risks associated with poor economic performance were felt to outweigh the problems of advance funding, a payroll tax increase that would take effect sooner could of course be designed, although it should be borne in mind that under current law a rise in the combined tax rates, from 11.4 percent to 12.4 percent, is already scheduled for 1990.

Effects of Fluctuations in Economic Performance over Time

In addition to the problems that could be caused by generally worse-than-expected economic conditions, there are, as mentioned earlier, some potential financing problems associated with temporary fluctuations in economic performance. Chapters VI and VII discussed some options aimed primarily at smoothing out these temporary financing difficulties, either by automatically adjusting benefit payments or by increasing revenues through borrowing or transfers to the trust funds when the economy is in recession.

Under current law, benefit payments rise relative to trust fund revenues when wages grow slowly relative to prices. This causes problems for the trust funds but may help to stabilize the economy, since in general Social Security spending will increase and revenues will fall as the economy moves into a recession while the reverse will occur as recovery begins to take place. Thus, the system acts in a countercyclical fashion, adding some stimulus to a declining economy and increasing revenues as the economy recovers.

One type of option for stabilizing trust fund balances would be to link benefit increases to some form of wage index or to the lower of wage and price increases, so that outlays could not rise faster than revenues. This would dampen the effects of temporary economic fluctuations on the trust funds, but would lessen the countercyclical impact of the Social Security system. If instead the trust funds were allowed to borrow or to receive general revenue transfers in periods of poor economic performance, their countercyclical effects would remain. Since this option would involve some funding for Social Security that did not come from earmarked tax revenues, however, many people feel that it would undermine the concept of trust fund financing for Social Security.

DISTRIBUTIONAL EFFECTS

Options for improving the financial position of the trust funds would also vary in their effects on different groups of workers and beneficiaries. In general, for most types of options there are trade-offs between maintaining the adequacy of retirement incomes for low-income beneficiaries and providing a fair rate of return on contributions for all workers. (These effects are summarized in Table 12.) Thus, options that would have their largest impact on those with high lifetime earnings, such as the proposal to reduce formula bend points or the proposal to eliminate the maximum taxable wage, generally would not reduce benefits for those with low incomes but would reduce the relative rate of return on Social Security taxes paid by high earners. That rate of return will already be lower, under current law, than the return received by lower-income workers, and some high-earning workers' expected Social Security benefits will be lower than their contributions to the system. Further reductions in their rate of return would exacerbate this situation.

On the other hand, reductions that affected all beneficiaries equally, such as a proportional reduction in the benefit formula, would reduce benefits for those with low incomes as well as for those with more resources, and could threaten the adequacy of retirement incomes for some recipients. Increases in the age of retirement could also have that effect, since those who retire early are likely to have both lower lifetime earnings and less access to other sources of retirement incomes than those who continue working. The impact of changes in the retirement age on benefit adequacy could be particularly large for those who have health problems that are not sufficiently severe to qualify them for disability benefits, or who become unemployed relatively late in life.

The trade-offs between income adequacy and provision of a fair rate of return also occur between generations. Current retirees are receiving relatively high rates of return on their Social Security contributions, both because of past benefit increases and because many have not contributed to the system over their entire working lives. Thus, options that focus entirely on those retiring in the fairly distant future would reduce rates of return for beneficiaries who, even under current law, will be receiving lower rates of

TABLE 12. SUMMARY OF DISTRIBUTIONAL EFFECTS OF SELECTED SOCIAL SECURITY OPTIONS, RELATIVE TO CURRENT LAW

Option	Reduces Benefits for Retirees with Low Lifetime Earnings	Reduces Relative Rate of Return for Those with High Lifetime Earnings	Reduces Benefits for Current Retirees or Those Retiring in Near Future	Reduces Rate of Return for Current Workers Relative to Current Retirees
Benefit Reductions				
Formula change				
Change in bend points[a]		X		X
Proportional reduction[b]	X			X
Increase in the age of retirement				
Increase in the reduction factor for early retirement[c]	X		X	
Increase in the age of eligibility for benefits[d]	X			X
Tax Increases				
Increases in payroll tax rates of 1.1 percentage points in 2020 and 2030[e]				X
Taxation of one-half of OASI benefits[f]		X	X	

SOURCE: Congressional Budget Office.

a. Proposal to index bend points by 75 percent of wage increases for 12 years starting in 1984. This proposal would also affect retirees with low lifetime earnings, but generally not as much as the proportional reduction proposal. See discussion in Chapter IV for more details.

b. Proposal to reduce percentage of earnings replaced by benefits proportionally in each bracket of formula by about 8 percent over 12 years starting in 1984.

c. Administration's May 1981 proposal to reduce benefits for age 62 retirees from 80 percent to 55 percent of full benefits, effective immediately.

d. 1981 National Commission proposal to raise eligibility age by 3 months per year for 12 years, beginning in 2001.

e. Proposal to increase payroll tax rates to 6.75 percent each for employees and employers in 2020, and to 7.30 percent in 2030. Payroll tax rates for the self-employed would be increased commensurately.

f. Estimate preliminary and subject to revision. Assumes implementation as of 1984; could also be phased in.

return than those who are now retired. If such options were combined with tax increases affecting current workers, who will become future beneficiaries, rates of return for this group would fall even more. On the other hand, workers in general have higher incomes than beneficiaries, and incomes are projected to grow over time, so reductions affecting current workers or future beneficiaries might have less impact on income adequacy than would reductions in the benefits of current recipients.

Options to stabilize trust fund balances would also be subject to some of the same concerns. If the trust funds were supplemented from general revenues during a recession, the costs associated with poor economic performance would in effect be borne by taxpayers rather than beneficiaries. If benefits were linked to some form of wage index or to the lower of wages or prices, on the other hand, the purchasing power of benefits would decline, reducing their adequacy. During an extended recession, such a plan could significantly increase poverty rates for older Americans.

Stabilization measures that did not maintain the purchasing power of benefits could also introduce inequities between those retiring in different years, since those who retired during a period of recession would have lower real lifetime benefits than those who retired while the economy was performing well. Even if some provision was made to provide additional benefit increases in recovery periods for those whose real benefits had declined, some inequities would remain, since some retirees who had lost benefits would die before their losses were made up. Further, unless separate benefit adjustments were computed for those retiring in each year, workers who retired at the beginning of a "catch-up" period would also experience gains, even though their benefits had never been reduced.

Another set of concerns involves the relative sizes of the groups affected by options of different types. In general, options that are very narrow in their focus--that is, those that affect only very small and specific groups of people--must have a greater impact on those affected than would broader options if they are to generate comparable savings or revenue increases. For example, since there are many more workers than beneficiaries at any given time, options to raise taxes on earnings would generally reduce each worker's net income by less than the reduction that would have to be made in each beneficiary's income to improve trust fund balances by the same total amount. Similarly, options or combinations of options affecting all retirees would be broader in focus than those affecting new recipients only.

In general, this paper considers options focusing on narrowly defined groups only when their purpose would be to treat members of those groups more like other workers and beneficiaries. Coverage of federal employees and universal coverage are examples of such options, and elimination of the maximum taxable wage might also fall into this category. The partial taxation of Social Security benefits could also reduce some existing discrepancies in treatment, both between retirees with income primarily from Social Security and those with some income from savings or private pensions, and between Social Security recipients in general and non-aged people with similar total incomes.

COMBINATIONS OF OPTIONS

As noted in the first part of this chapter, no single option discussed in this paper could of itself solve the system's projected financing problems. For this reason, it may be desirable to consider some possible combinations of options.

Such a combination would be subject to the same general concerns as apply to the assessment of individual options: the magnitude of the options' combined effects, when these effects would occur, and their combined distributional impact. This section briefly outlines the advantages and drawbacks of three combinations, including a combination of reductions in benefits, a combination of payroll tax increases, and a combination of tax increases and benefit reductions.

Combinations of Benefit Reductions

A combination of options reducing benefits could be designed to produce sufficient total savings to offset the projected trust fund deficit, with some flexibility in timing. Options such as increases in the retirement age that would not take effect for some time could be combined with options such as formula changes that would provide some additional resources in the next two decades, and with options like temporary reductions in cost-of-living adjustments that would address the short-run financing problem. This would provide an additional margin of safety for the trust funds in the relatively near future, while avoiding larger changes in the program until they became necessary.

The impact on beneficiaries of two or more benefit-reduction options in combination could, however, be very large. Table 13 shows, for example, the impact of combining a formula change option with an increase in the age of retirement for workers earning minimum, average, and high wages. By 2020, after full phase-in, either of these two options could mean substantial benefit cuts relative to current law.

TABLE 13. PERCENTAGE REDUCTIONS IN MONTHLY BENEFITS FOR BENEFICIARIES BECOMING 65 IN 2020 WITH LIFETIME EARNINGS AT THREE WAGE LEVELS, UNDER A COMBINATION OF PROPOSALS TO REDUCE BENEFITS

Wage Level	Age at Retirement		
	Age 62	Age 65	Age 68
		Raising Retirement Age[a]	
Minimum Wage[b]	100.0	17.2	6.0
Average Wage[c]	100.0	17.4	6.4
Maximum Wage[d]	100.0	17.1	5.7
		12-Year Restriction on Bend Points[e]	
Minimum Wage[b]	7.7	7.6	7.5
Average Wage[c]	4.8	4.8	4.7
Maximum Wage[d]	8.6	8.5	8.4
		Combination of Raising Retirement Age and Restriction on Bend Points	
Minimum Wage[b]	100.0	23.6	13.2
Average Wage[c]	100.0	21.4	10.9
Maximum Wage[d]	100.0	24.2	13.8

SOURCE: Congressional Budget Office.

a. 1981 National Commission proposal to raise the eligibility age for full benefits to 68 and for reduced benefits to 65, starting in 2001. See Chapter V for details.

b. Calculations are based on the earnings of a full-time minimum wage earner. Minimum wage after 1982 is assumed to increase with growth in average wages.

c. Calculations are based upon the earnings of a worker who earned the average wages in the economy.

d. Calculations are based upon the earnings of a worker who earned the Social Security taxable maximum.

e. Proposal to index bend points in the benefit computation formula by 75 percent of wage increases for 12 years, starting in 1984. See Chapter IV for details.