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December 15, 1998

## **THE FELDSTEIN SOCIAL SECURITY PLAN**

by Robert Greenstein, Wendell Primus, and Kilolo Kijakazi

### **Introduction and Overview**

Increasing attention is being paid to a Social Security proposal developed by Martin Feldstein, a Harvard economist and former chairman of the Council of Economic Advisers under President Reagan. The Feldstein plan is generally presented as a painless way to restore Social Security solvency without any reductions in the level of benefits the current benefit structure promises, with no tax increases, and, in fact, with almost all retirees receiving *greater* retirement income than under current law. When something appears too good to be true, it usually is. This adage holds for the Feldstein proposal.

While proponents of the plan claim it would restore long-term Social Security solvency with no pain, analyses of the plan — including analyses by the Congressional Budget Office and the Office of the Chief Actuary at the Social Security Administration — show otherwise. The Social Security system faces insolvency because the system has promised more in benefits than it will collect in revenues. The Feldstein plan promises *more* in retirement benefits than current law would provide but collects no more revenue to cover the added costs. The Feldstein plan would devote much of the surplus projected in the unified budget to finance the increases the plan would provide in retirement benefits. These surpluses, however, are uncertain in magnitude, are not expected to last for more than about two decades, and have other claims on them. When the surpluses wane, major new financing would have to be found. That would entail cutting other parts of the federal government heavily, imposing large tax increases, or borrowing substantial sums and swelling the already-large budget deficits that CBO forecasts will return when the baby boom generation has retired. The Social Security actuaries project that in the absence of budget cuts or tax increases to pay for the plan, *the Feldstein proposal would reduce budget surpluses and then increase deficits by \$6.4 trillion over the next 25 years.*<sup>1</sup>

The Feldstein plan essentially poses as a "free lunch" entailing no tough choices. This appearance, however, is deceptive. The plan leaves a gaping hole in financing that future Congresses would have to address. The plan is reminiscent in this respect of the

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<sup>1</sup> Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Long-Range OASDI Financial Effects of Clawback Proposal for Privatized Individual Accounts — INFORMATION," December 3, 1998.



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**Ellen Nissenbaum**  
*Legislative Director*

Tel: 202-408-1080  
Fax: 202-408-1056  
[nissenbaum@cbpp.org](mailto:nissenbaum@cbpp.org)  
<http://www.cbpp.org>  
HNOO26

820 First Street, NE, Suite 510, Washington, DC 20002



December 15, 1998

**SOCIAL SECURITY PLANS THAT REDUCE SOCIAL SECURITY RETIREMENT  
BENEFITS SUBSTANTIALLY ARE LIKELY TO CUT  
DISABILITY AND SURVIVORS BENEFITS AS WELL**

by Kathy Larin and Robert Greenstein

The Social Security debate now underway has focused primarily on retirement benefits. Much less attention has been paid to how various changes being proposed in the Social Security benefit structure would affect disability and survivors benefits. To assess any Social Security reform plan fully, however, the impact on disability and survivors benefits should be carefully scrutinized.

This issue is particularly important because Social Security reform proposals that entail large reductions in Social Security retirement benefits generally contain substantial reductions in disability and/or survivors benefits as well. This is a result of the Social Security benefit structure, which uses a common benefit structure to determine monthly benefit levels for retirement, survivors and disability benefits alike.

Various proposals now emerging would shift a portion of Social Security payroll tax revenues from the Social Security trust funds to private individual accounts. Under a number of these proposals, beneficiaries would be guaranteed a "defined benefit" from the Social Security trust fund, as under current law, and receive supplemental income from their individual accounts. Such proposals generally entail quite large reductions in Social Security benefits — those benefits must be cut enough to close the current long-term shortfall in Social Security's finances and then reduced further to make up for the loss of the revenues being diverted from the trust funds to individual accounts. For example, diverting two percentage points of the payroll tax to private accounts, as some proposals do, would nearly double the size of the long-term Social Security shortfall and thus substantially deepen the Social Security benefit reductions required to restore long-term solvency to the system. As a result, proposals that shift revenue from the Social Security trust funds to private accounts generally entail large reductions not only in Social Security retirement benefits, but also in Social Security disability and survivors benefits.

Substantial reductions in disability and survivors benefits pose a particular problem. Although the income from individual accounts may make up for the loss of a substantial portion or all of lost Social Security *retirement* benefits for some individuals, depending on how the stock market performs, the individual's investment decisions, and other factors, income from individual accounts can *not* make up for much of the loss of Social Security disability benefits by workers who become disabled well before retirement age or for the loss of survivors benefits by the spouses and dependents of

workers who die well before retirement age. The individual accounts of such workers will not have accumulated sufficient assets to make up for the reduction in disability and survivors benefits.

Aggravating this problem and sharpening the impact of the loss of Social Security disability and survivors benefits is the fact that such benefits often involve multiple benefit payments — they entail payments to dependents as well as to the disabled worker or the surviving spouse of a deceased worker. That a death or disabling accident can trigger Social Security benefit payments to *a number of* individuals rather than just to *one* beneficiary makes it even more difficult for the income from a single individual account to compensate for reductions in disability and survivors benefits.

### **Legislation Based on the NCRP Plan As An Example**

To illustrate this problem, we examine legislation introduced by Senators Judd Gregg and John Breaux and Reps. Jim Kolbe and Charles Stenholm (S. 2313 and H.R. 4824). This legislation is based on a Social Security proposal unveiled this spring by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens.<sup>1</sup> Other plans entailing reductions in Social Security retirement benefits also would affect disability and survivors benefits to various degrees, as the box on page \_\_\_ explains.

In issuing its plan, the National Commission on Retirement Policy expressed its intention to protect disability benefits from cuts. Subsequent statements by proponents of this legislation also reflect that intent. For example, at the town hall meeting held to discuss Social Security reform in Albuquerque on July 27, 1998, Rep. Kolbe stated, "...our proposal does not touch the disability or the survivors....we keep [disability] intact; it's exactly as it will be."<sup>2</sup>

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<sup>1</sup> This House bill was originally introduced as H.R. 4256 and then re-introduced as H.R. 4824 to reflect technical corrections and correct some drafting errors in the first bill. S. 2313 was introduced at the same time as H.R. 4256 and does not include these corrections. This analysis assumes the same changes will be made to the Senate bill. The bill numbers for both the House and Senate bills will change when the bills are reintroduced during the next session of Congress.

<sup>2</sup> Social Security has two trust funds, the Old Age and Survivors Insurance trust fund, which funds retirement and survivor benefits, and the Disability Insurance trust fund, which funds disability benefits. Both trust funds are projected to become insolvent in coming decades. Because the two trust funds are essentially fungible, Social Security solvency can be restored by making changes that make the overall system solvent and adjusting accordingly the share of Social Security revenues placed in each trust fund. To restore solvency, it is not necessary to reduce disability benefits by some particular amount or percentage. To the degree that disability benefits are shielded, somewhat larger changes likely would be needed in retirement benefits.

But in drafting the legislation based on this plan, the sponsors of S. 2313 and H.R. 4824 found that despite their strong desire not to cut disability benefits, it was not feasible to institute the large reductions in Social Security retirement benefits their plan entailed without making substantial reductions in disability and survivors benefits as well.<sup>3</sup> The only way the NCRP legislation could have made its reductions in Social Security retirement benefits without substantially reducing disability benefits at the same time would have been through measures that would introduce severe inequities and perverse incentives into the Social Security benefit structure.

The NCRP does contain a mitigating provision — it establishes a minimum benefit that would largely or fully shield from these benefit reductions those disabled workers who earned well-below-average wages during their work-years and were employed for most or all of their adult lives before becoming disabled. This provision also would shield survivors of deceased workers who earned very low wages and were employed most of their adult lives, as well as retirees who earned very low wages during their work years. Due to this provision, some retirees, disabled individuals, and survivors of deceased individuals who earned very low wages before retiring, becoming disabled, or dying actually would receive larger Social Security benefits than under current law.

For disabled workers and survivors who would *not* be affected by the minimum benefit provision, however — a group constituting the majority of beneficiaries of disability and survivor benefits — the benefit cuts would be large. For example, when the legislation took full effect, the Social Security disability benefits provided to an individual who had earned average wages before becoming disabled would be reduced nearly 20 percent, as compared to current law.

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<sup>3</sup> In theory, the legislation based on the NCRP plan could have left disability and survivors benefits largely untouched. This could have been accomplished by replacing the plan's changes in the Social Security basic benefit formula and in the annual Social Security cost-of-living adjustment with much steeper increases in the age at which workers can retire and receive full Social Security benefits. Raising the age at which beneficiaries can retire and receive full benefits does not affect disability benefit levels or benefits for survivors of workers who die before reaching retirement.

In practice, however, such a change would hold little attraction. The NCRP plan already contains a larger increase in the age at which beneficiaries can retire and receive full benefits than any other major Social Security plan put forward. Of the three rival Social Security plans advanced by members of the 1994-1996 Social Security Advisory Council, the plan that went farthest in raising the age at which individuals can retire and receive full benefits would increase this age from 65 today (and, under current law, 67 starting in 2022) to age 70 by 2083. By contrast, the NCRP plan would raise the age to 70 by 2029 and to approximately 72½ by 2075. The NCRP also would raise the age at which *early* retirees can begin to receive reduced Social Security benefits from 62 to 65 by 2029 and to approximately 67½ by 2075. Replacing those provisions of the NCRP plan that would result in substantial reductions in disability and survivors benefits with provisions requiring still greater increases in the retirement age would entail raising the age at which workers may retire and receive full benefits to levels significantly higher than those the NCRP plan already proposes.

The legislation includes a provision calling for an expert panel to study and make recommendations concerning possible future changes that could ease the reductions in disability benefits the legislation contains. This panel, however, would face the same dilemmas that led the sponsors of S. 2313 and H.R. 4824 reluctantly to include substantial disability benefit reductions in their bills, since there is no easy solution that eluded the legislation's framers. Moreover, the legislation specifies that any recommendations the panel might make to ease the legislation's disability benefit cuts after the legislation had been enacted would have to be accompanied by recommendations for offsetting reductions elsewhere in the Social Security Disability Insurance program so that disability insurance costs did not rise above the levels to which the legislation had reduced them.

### **Background on Disability and Survivors Benefits**

The Social Security system provides benefits not only to retirees but also to the survivors of workers who die before reaching age 62 and to workers who become disabled before 62 and their dependents.

- Workers who become disabled before they reach retirement, as well as members of these workers' families, are eligible for benefits under the disability insurance program that is part of Social Security.<sup>4</sup>
- Survivors benefits are available to the children of workers who have died before reaching retirement and the spouses of such deceased workers if the spouses are caring for dependent children, are over 60, or are disabled themselves. Survivors benefits also go to spouses and minor children of workers who die after retiring.

In December 1996, disabled workers and their families comprised more than six million people, or nearly 14 percent of all Social Security beneficiaries. An additional 7.4 million beneficiaries, nearly 17 percent of all Social Security beneficiaries, were survivors and their families. Together, these two components of Social Security account for nearly one-third of Social Security beneficiaries — 13 million to 14 million people.

### **How Disability and Survivors Benefits are Determined**

The level of disability or survivors benefits that beneficiaries receive is determined under the same benefit formula as is used to calculate Social Security

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<sup>4</sup> To receive Social Security disability benefits, disabled workers must have worked one quarter for each year between the year they turned 21 and the year they become disabled, with a minimum of six quarters of work. They also must have worked 20 of the 40 quarters before becoming disabled if they become disabled after age 31 and half of the quarters between the time they turn 21 and the time they become disabled if they become disabled before turning 31.

retirement benefits. The benefit formula starts with the calculation of a covered worker's "average indexed monthly earnings"; these are the worker's average wages over his or her work career. Wages for each year from the past are indexed by national wage growth to account for wage inflation between the year the worker earned those wages and the year that falls two years before the time the worker becomes eligible for benefits.

For *retirees*, the highest 35 years of wages are indexed in this manner, averaged and divided by 12 to obtain the worker's "average indexed monthly earnings" (known as the worker's AIME). For the *disabled* and *survivors*, a worker's average indexed monthly earnings are calculated using wages for the years between the time the worker turned 21 and the time the worker became disabled or died. For most Social Security beneficiaries, up to five of the years in which the worker had the lowest earnings are disregarded in these calculations.<sup>5</sup>

The worker's average indexed monthly earnings are then used to determine what is known as the worker's "primary insurance amount" or PIA. A worker's monthly Social Security benefit is based on his or her PIA. Specifically, for workers who retire at age 65, for disabled beneficiaries, and for the survivors of workers who die before reaching retirement, the monthly Social Security benefit they receive when they begin drawing benefits *equals* their PIA, rounded down to the next lowest dollar.

The calculation of the primary insurance amount, which determines the monthly benefit, is done in the same fashion *regardless of whether the beneficiary is a retiree, disabled, or a survivor*.<sup>6</sup>

- For a retiree, a disabled worker, or a survivor of a deceased worker who becomes eligible for Social Security benefits in 1998, the PIA — and hence

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<sup>5</sup> For survivors, the lowest five years of wages (known as "drop-out years") are disregarded in the calculation of the AIME unless the worker died before working seven full years, in which case all but the two highest wage years are disregarded in the calculation. For the disabled, depending on the age of the worker at the time of disability and the number of years worked, up to five years in which the worker earned the lowest wages are disregarded in the computation of the AIME. (As an example, if a worker who worked since age 21 becomes disabled at 31, the highest eight years of wages are indexed and averaged to determine the worker's AIME, while the two years with the lowest wages are disregarded.) By omitting from the AIME calculation the years in which the worker earned the least, the Social Security benefit structure ensures that workers who were either unemployed for brief periods or left the labor force for a few years to provide child care, attend college, or for other reasons are not penalized.

<sup>6</sup> A disabled worker's benefit is equal to 100 percent of the worker's PIA rounded down to the next dollar. Each dependent of the disabled worker is eligible to receive an additional benefit equal to 50 percent of the worker's PIA. Widows and widowers of deceased workers and minor or disabled children of deceased workers are eligible for a survivor's benefit based on a portion of the deceased worker's PIA. The combined benefits of all beneficiaries in a family (except divorced spouses) cannot exceed a maximum level, or cap.

**Table 1**  
**Determination of a Worker's Monthly Benefit Under Current Law,**  
**for a Worker Becoming Eligible for Benefits in 1998<sup>7</sup>**

| <b>Formula using worker's Average Indexed Monthly Earnings (AIME)</b> | <b>Worker with AIME of \$972 (Low earner)</b> | <b>Worker with AIME of \$2,162 (Average earner)</b> | <b>Worker with AIME of \$5,225 (Maximum earner)</b> |
|-----------------------------------------------------------------------|-----------------------------------------------|-----------------------------------------------------|-----------------------------------------------------|
| 90% of first \$477                                                    | \$429.30                                      | \$429.30                                            | \$429.30                                            |
| 32% of AIME between \$477 and \$2,875                                 | \$158.40                                      | \$539.20                                            | \$767.36                                            |
| 15% of AIME over \$2875                                               |                                               |                                                     | \$352.50                                            |
| Primary Insurance Amount (PIA)                                        | \$587.70                                      | \$968.50                                            | \$1,549.16                                          |
| Benefit Level <sup>8</sup>                                            | \$587.00                                      | \$968.00                                            | \$1,549.00                                          |

<sup>7</sup> Table 1 shows monthly benefit calculations for workers with low earnings, workers with average earnings, and workers with "maximum" earnings. The low earner—the worker with an AIME of \$972—has an AIME equal to 45 percent of the average earnings level. The "maximum" earner—the earner with an AIME of \$5,225—has an AIME equal to the maximum earnings subject to the Social Security payroll tax. The earnings levels shown here for low earners and maximum earners are the levels the Social Security Administration uses for illustrative purposes.

<sup>8</sup> The benefit level equals the primary insurance amount rounded down to the next dollar.

the monthly Social Security benefit after rounding to the next lowest dollar — equals 90 percent of the worker's average indexed monthly earnings after rounding to the next lowest dollar *if* the worker's AIME does not exceed \$477 a month.

- If the worker's AIME falls between \$477 and \$2,875 a month, the PIA (and, after rounding down, the monthly Social Security benefit) equals 90 percent of the first \$477 of the worker's average indexed monthly earnings, plus 32 percent of the worker's average indexed monthly earnings above \$477.
- For workers with AIMEs exceeding \$2,875, the PIA (and the monthly Social Security benefit after rounding) equals 90 percent of the first \$477 in average indexed monthly earnings, plus 32 percent of the next \$2,398 of those earnings (the amount between \$477 and \$2,875), plus 15 percent of the worker's AIME in excess of \$2,875.

Table 1 shows the monthly benefit calculations for three workers with different levels of average indexed monthly earnings. The "low earner" is an earner with an

AIME equal to 45 percent of the average earnings level. A "low earner" retiring in 1998 would have average annual pre-retirement earnings of about \$12,250. An average earner retiring this year would have average annual pre-retirement earnings of just under \$26,000. A maximum earner is one whose average pre-retirement earnings equal the maximum amount of earnings subject to the Social Security payroll tax. Earnings above this level are neither subject to the payroll tax nor used to calculate an individual's Social Security benefit level.

### **Provisions of the NCRP Legislation that Affect Disability and Survivors Benefits**

Most of the remainder of this paper uses the legislation based on the NCRP proposal, the legislation Senators Gregg and Breaux and Reps. Kolbe and Stenholm have introduced, to illustrate how changes in disability and survivors benefits can be intertwined with changes in Social Security retirement benefits. The major provisions of this legislation that relate to Social Security benefit levels are listed in Table 2. Some of these provisions affect only the retirement portion of Social Security, but others impact disability and survivors benefits as well.

**Table 2**  
**Major Social Security Benefit Provisions of H.R. 4824 and S. 2313**

| <b>Provisions</b>                                                                    | <b>Effect on Disability and Survivors Benefits</b>                                                                                             |
|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|
| Change the formula for calculating the primary insurance amount                      | Reduces benefits for most beneficiaries, with a reduction of 18.5 percent for a worker earning average wages before becoming disabled or dying |
| Minimum benefit provision                                                            | Protects the benefits of survivors and disabled workers with low earnings and strong labor force attachment                                    |
| Modify cost-of-living adjustments so they rise more slowly than the current CPI does | Affects benefits of all beneficiaries, including the disabled and survivors                                                                    |
| Reduce the number of "drop-out years" and lengthen the wage averaging period         | Reduces survivors benefits                                                                                                                     |
| Raise the retirement age                                                             | Primarily affects retirement benefits and the benefits of survivors of retired workers                                                         |
| Include state and local employees                                                    | No effect                                                                                                                                      |

**Table 3**  
**Benefit Calculations Under NCRP**  
**Legislation and Current Law**

| <b>Under current law, the monthly benefit equals:</b>        | <b>Under H.R. 4824 and S. 2313, when fully phased in, the monthly benefit equals:</b> |
|--------------------------------------------------------------|---------------------------------------------------------------------------------------|
| 90% of first \$477 in average indexed monthly earnings, plus | Same                                                                                  |
| 32% of AIME between \$477 and \$2,875, plus                  | 21.36% of AIME in this bracket, plus                                                  |
| 15% of AIME above \$2,875                                    | 10.01% of AIME in this bracket                                                        |

### Change in Benefit Determination Formula

One of the major provisions of this legislation would alter the way in which retirement, disability, and survivors benefits are calculated. The legislation calls for changing the computation of a worker's monthly benefit by reducing, by the year 2023, the 32 percent bracket in the formula for computing a worker's primary insurance amount to 21.36 percent, and reducing the 15 percent bracket to 10.01 percent. Thus, an individual's monthly benefit would be calculated by taking 90 percent of the first \$477 of the worker's AIME (in 1998 dollars), the same percentage as under current law, but 21.36 percent of the worker's AIME between \$477 and \$2,875 instead of 32 percent of this amount, and 10.01 percent of the worker's AIME over \$2,875 instead of 15 percent of that amount. The proposed change is shown in Table 3.

For very low-wage earners — those with average indexed monthly earnings of \$477 or less — these changes would have no impact. In fact, very low-wage workers who work most or all years between turning 21 and becoming eligible for benefits would likely receive an increased benefit as a result of the legislation's minimum benefit provision, discussed below in more detail. But for beneficiaries with modestly below-average, average or above-average earnings, as well as for most beneficiaries who earned very low wages but were not employed each year between the time they turned 21 and the time they became eligible for benefits, this change would reduce the monthly Social Security benefit. Because this change in the benefit formula would affect the computation of disability and survivors benefits as well as retirement benefits, it would reduce disability and survivors benefits along with retirement benefits.

For many workers, the impact of this change on disability and survivors benefits would be substantial. An analysis by the Social Security Administration's Chief Actuary shows that this change in the monthly benefit formula would reduce benefits to a disabled Social Security beneficiary who earned average wages, which equal

**Table 4**  
**Determination of the Monthly Benefit for an Average-wage Worker Who Becomes Disabled Under H.R. 4824 and S. 2313, When Fully Implemented**

| <b>Formula Using Worker's Average Indexed Monthly Earnings (AIME)</b> | <b>Average-Wage Worker</b> |
|-----------------------------------------------------------------------|----------------------------|
| 90% of first \$477                                                    | \$429.30                   |
| 21.36% of AIME between \$477 and \$2,875 (worker's AIME is \$2,162)   | \$359.92                   |
| 10.01% of AIME over \$2,875                                           | \$0                        |
| Monthly benefit under H.R. 4824 and S. 2313                           | \$789.00                   |
| Monthly benefit under current law (see Appendix Table 1)              | \$968.00                   |
| Reduction in monthly benefit                                          | -\$179.00                  |
| Percentage benefit reduction                                          | -18.5 %                    |

\$27,894 in 1998, by 18.5 percent when the formula change was phased in fully.<sup>9</sup> (See Table 4.)

Survivors also would face reduced benefits. Under current law, for example, a 60-year-old surviving widow of an average-wage worker is eligible for a monthly benefit of \$692. If H.R. 4824 and S. 2313 were law and fully in effect, such a widow would receive a monthly benefit of \$564. This, too, is a reduction of 18.5 percent.

The percentage reduction in benefits would be smaller than 18.5 percent for workers with below-average wages. (And as noted, some very-low wage workers would be shielded entirely from this benefit reduction or receive a benefit increase due to the legislation's minimum benefit provision.) The benefit reduction would be greater than 18.5 percent for those who had earned above-average wages.

Because the primary insurance amount is calculated in the same manner for all Social Security beneficiaries, these percentage reductions in benefits would be the same regardless of whether the beneficiary is a retiree, a disabled worker or a survivor. The dependents of disabled workers and the families of survivors also would be affected, since their Social Security benefits equal a specified percentage of the worker's PIA. A reduction of a given percentage in a worker's PIA would cause the benefits for these dependents to be cut by the same percentage.

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<sup>9</sup> Social Security Administration, "Impact on Low Earners of Proposals to Address Long-Range Social Security Solvency" unpublished report, 1998.

Proponents of partial privatization plans often argue that reducing the basic guaranteed benefit payable to retirees through the Social Security retirement system will not necessarily reduce retirees' total incomes, because the retirees also will secure retirement income from the savings in their individual accounts. Income from these accounts could offset reductions in Social Security benefits; some beneficiaries would likely come out ahead and others behind, depending on how their investments performed, the costs and fees charged on the accounts, and a number of other factors.<sup>9</sup>

For the disabled and survivors of workers who die before retirement, however, individual accounts generally would fail to bridge the gap between current benefit levels and the benefits available under partial privatization legislation such as

**Adults Who Have Been Disabled Since Childhood Would be Affected Most Adversely**

One group for whom private accounts are least likely to compensate for the difference between current Social Security benefit levels and the reduced Social Security benefits available under partial privatization plans such as H.R. 4824 and S. 2313 consists of adults who have been disabled since childhood and who become eligible for Social Security when their parents retire, die, or themselves become disabled. "Disabled adult children," as these individuals are known, are eligible for a Social Security benefit equal to a specified percentage of their parent's primary insurance amount.

Both their parents and these disabled adult children would receive lower Social Security benefits under proposals such as H.R. 4824 and S. 2313 than under current law, because of the changes these bills make in determining a beneficiary's primary insurance amount. The parents of these disabled adult children also would accumulate private accounts to supplement their reduced Social Security retirement benefits. (The disabled adult children themselves will have little or no earnings and thus no significant private accounts of their own.) But while the amounts in the parents' private accounts might be sufficient to make up for a substantial portion or all of the reductions in the parents' Social Security benefits, it is unlikely these accounts would make up for the reduction in the benefits of the disabled adult children as well.

As a result, hardship could ensue. Consider, for example, what would occur after the parents of disabled adult children died. By the time of their deaths, many such parents would have largely or entirely depleted their private accounts. That would leave little or no savings to supplement the reduced Social Security benefits upon which their disabled adult children would have to depend for the rest of their lives.

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<sup>9</sup> See Kilolo Kijakazi and Robert Greenstein, "How Would Various Social Security Reform Plans Affect Social Security Benefits: An Analysis of the Congressional Research Service Report," Center on Budget and Policy Priorities, September 9, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; and testimony of Henry Aaron before the Senate Committee on the Budget, July 23, 1998.

H.R. 4824 and S. 2313. Workers who become disabled or die at a young age will not have accumulated much in their individual accounts, as they will not have contributed to these accounts for that many years. For many of these individuals and their families, the change that H.R. 4824 and S. 2313 would make in the calculation of the monthly benefit would result in a significant reduction in monthly income compared to what they would receive under current law.<sup>10</sup>

### **Change in Cost-of-Living Adjustments**

These estimates of the percentage amounts by which disability and survivors benefits would fall due to the changes H.R. 4824 and S. 2313 would make in computing the primary insurance amounts do not reflect the full extent of the reductions in disability and survivors benefits that would occur under these bills. Additional benefit reductions would result from other changes the bills would make in determining benefit levels, such as changes in the Social Security cost-of-living adjustment.

Under current law, Social Security benefits rise each year by the percentage increase in the Consumer Price Index. H.R. 4824 and S. 2313 would change this; they would adjust Social Security benefits not by the CPI but by a new "Social Security Consumer Price Index" that the legislation would create. The Social Security CPI would equal the regular CPI *minus* an estimate of the amount of "substitution bias" remaining in the regular CPI.

Substitution bias can occur when consumers substitute lower-cost items for higher-cost items as prices change. For example, if the price of beef increases more than the price of chicken, consumers will tend to purchase less beef and more chicken. Because the CPI measures the change in prices of a fixed "market basket" of goods and services, it assumes the quantities of beef and chicken a typical consumer buys do not change each year. The CPI is adjusted once every 10 years for such changes in purchasing patterns, but this process does not capture changes in purchasing patterns on a year-to-year basis within the 10-year intervals. As a result, the index may overstate inflation to some degree.

H.R. 4824 and S. 2313 would require the Bureau of Labor Statistics, the agency that calculates the CPI, to publish annually the amount by which the CPI has been reduced to correct for substitution bias. BLS also would be required to publish an estimate of the amount of substitution bias remaining in the CPI. Under the legislation, the Social Security CPI would equal the CPI (including whatever corrections the BLS has made in it) minus any substitution bias BLS estimates to remain.

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<sup>10</sup> Workers who become disabled only shortly before reaching retirement age would have accumulated more in their individual accounts and thus would receive more income from these accounts.

The legislation also contains a related requirement — that in calculating the Social Security CPI, the CPI must be reduced *no less than 0.5 percentage points* to compensate for substitution bias, regardless of BLS' estimate of how much substitution bias remains. In April 1998, BLS announced improvements in the CPI that will reduce substitution bias in the index by 0.2 percentage points when the improvements are incorporated in the index in 1999. BLS plans to make additional changes in 2002 that are expected to reduce substitution bias an additional 0.15 percentage points, for a total reduction of 0.35 percentage points.<sup>11</sup> BLS is not planning any further changes to adjust for substitution bias; it estimates the adjustments now in process will resolve the substitution bias problem. In the absence of further changes, however, the Social Security CPI that the NCRP legislation establishes would be set approximately 0.15 percentage points below the CPI, as corrected by BLS, to secure the minimum 0.5 percentage point reduction for substitution bias the legislation requires.<sup>12</sup>

Over time, the effect of such a downward adjustment each year in the cost-of-living adjustment would be to erode the value of Social Security benefits relative to current law. These benefit reductions would tend to be largest for workers who become disabled well before reaching retirement age, since these beneficiaries typically receive benefits for a greater number of years than retirees do.

The provision's impact on a disabled worker who becomes eligible for Social Security at a relatively young age can be seen with an example. Consider a worker with average indexed monthly earnings of \$2,083 (equivalent to average annual earnings of \$25,000 in 1998 dollars) who becomes disabled at age 30. Under current law, the worker's benefit is \$943 a month when he or she begins to draw it. When fully in effect, the provision of H.R. 4824 and S. 2313 that would change the formula for calculating a worker's primary insurance amount would reduce this benefit to \$772 a month, an 18 percent reduction. Now assume that inflation as measured by the CPI

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<sup>11</sup> Technically, the substitution bias correction scheduled for 2002 cannot be made in the CPI itself because the data needed to make this correction are not available in a manner that allows them to be reflected in the monthly CPI data. As a result, BLS plans to introduce a second cost-of-living index in 2002 that essentially is the CPI as modified to reflect this substitution-bias correction.

<sup>12</sup> A commission charged with evaluating the CPI and chaired by Michael Boskin concluded in 1996 that the CPI was overstated by approximately 1.1 percentage points per year, with substitution bias accounting for 0.4 percentage points of the total. BLS now estimates that substitution bias causes the index to be overstated by 0.35 percentage points. The change to the CPI scheduled for 1999 will eliminate 0.2 percentage points of this bias, and the introduction of a new cost-of-living index in 2002 will eliminate an additional 0.15 percentage points of bias.

BLS periodically reevaluates and makes changes to the CPI. It is unlikely, however, that the BLS will make corrections for substitution bias that total 0.5 percentage points any time soon. As a result, under H.R. 4824 and S. 2313, the annual Social Security cost-of-living adjustments would be smaller than the CPI, which would result in Social Security benefit reductions compared to current law.

**Table 5**  
**Potential Impact of Cost-of-Living and PIA Changes In**  
**H.R. 4824 and S. 2313 on Disability and Survivors Benefits**

| <b>Worker with AIME of \$2,083 (\$25,000 per year)<br/>who becomes disabled at age 30</b> |                    |                              |
|-------------------------------------------------------------------------------------------|--------------------|------------------------------|
|                                                                                           | <b>Current Law</b> | <b>H.R. 4824 and S. 2313</b> |
| Benefit at age 30                                                                         | \$943              | \$772                        |
| Average annual cost-of-living adjustment                                                  | 2.5 %              | 2.35%                        |
| Benefit at age 60                                                                         | \$1,978            | \$1,550                      |

averages 2.5 percent per year for the next 30 years and BLS does not introduce additional changes to the CPI to reduce substitution bias, beyond the 0.35 percentage point reductions already scheduled. Under the legislation, the worker's benefit would be raised an average of 2.35 percent per year to compensate for inflation rather than 2.5 percent, because the Social Security cost-of-living adjustment would equal the regular CPI minus 0.15 percentage points. By age 60, this would reduce the worker's benefit an additional four percent, bringing the total reduction in Social Security disability benefits paid at age 60 to 22 percent, compared to the benefit payable under current law. Instead of receiving a disability benefit of \$1,978 per month at age 60 as under current law, the disabled worker would receive \$1,550. (See Table 5.)

#### **Another Change Affecting Survivors Benefits**

H.R. 4824 and S. 2313 include another provision that would lower the Social Security benefits of many survivors, although it would not affect the disabled. Under current law, the five years of a beneficiary's lowest earnings are omitted from the calculation of the beneficiary's average indexed monthly earnings. (In Social Security parlance, these are termed "drop-out years.") Under H.R. 4824 and S. 2313, by contrast, the five lowest years of earnings would be counted rather than dropped when computing retirement and survivors benefits. No similar change would be made in computing disability benefits.<sup>11</sup>

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<sup>11</sup> Currently, when figuring retirement benefits, the amounts a worker has earned in his or her 35 highest earnings years are indexed, added, and divided by 420 (which equals 35 years times 12 months) to determine the worker's average indexed monthly earnings. Under H.R. 4824 and S. 2313, *all* of a worker's earnings years would be totaled and then divided by 480 (which equals 40 years times 12 months).

For one group of retirees and survivors of retirees, this change could *raise* average indexed monthly earnings and hence Social Security benefits. These are retired workers, and survivors of retired

(continued...)

Most workers do not have the same earnings each year of their working lives; they have low earnings when they are young and higher earnings when they are older. More than 60 percent of workers take at least one year out to raise children, attend school, or for some other reason, and have zero earnings for one or more years. The provision of current law disregarding the five lowest earning years helps these workers. Including rather than disregarding these five years, as H.R. 4824 and S. 2313 would do, would lower average indexed monthly earnings — and hence monthly Social Security benefits — for many retirees and survivors of deceased workers.

Other proposals to reform Social Security that either reduce the number of drop-out years or average the highest 38 years of earnings when computing retirement benefits, rather than the highest 35 years as under current law, also would lower workers' AIMEs and reduce their benefits. For example, the Social Security plan that Robert Ball has developed would calculate the AIME for retirees using their highest 38 years of earnings. This provision of the Ball plan would reduce benefits modestly for most retirees and most survivors of workers who died after reaching retirement age. Because the Ball plan does not reduce the number of drop-out years, however, this aspect of it should not affect the benefits of the disabled or of survivors of workers who die before reaching retirement age (with the exception of some individuals who become disabled very close to retirement age and some survivors of workers who die very close to retirement age).<sup>13</sup>

### **Minimum Benefit Provision**

Although the majority of disabled and survivor beneficiaries would receive reduced benefits under H.R. 4824 and S. 2313, not all beneficiaries would face cuts. Workers with very low earnings and strong labor force attachment would be protected by a provision in the legislation that provides a guaranteed minimum benefit. This

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<sup>11</sup> (...continued)

workers, who began working and earning significant wages before age 21 and who worked most or all of the year in nearly every year until they retired. For these workers, more than 40 years of earnings would be totaled when figuring their AIME, but these total earnings would be divided by 40 years times 12 months, rather than by the actual number of years the individual had worked times 12 months. For some of these workers, this would result in a higher AIME, and hence higher benefits, than under current law. The majority of beneficiaries of Social Security retirement and survivors benefits, however, would not benefit from this change and would face lower benefits as a result of inclusion of their lowest-earning years in the benefit computation.

<sup>13</sup> In addition to the provisions of H.R. 4824 and S. 2313 discussed here, provisions of these bills and of various other Social Security plans that would raise the age at which full Social Security benefits are paid could affect the benefits of some individuals who become unable to work shortly before reaching that age but are not sufficiently disabled at that point to meet the rather stringent Social Security disability test.

## How Other Social Security Plans Would Affect Disability and Survivors Benefits

Other Social Security plans that have been proposed also would affect disability and survivors benefits, although they generally would do so to a lesser degree than H.R. 4824 and S. 2313. For example, the plan introduced by Senators Daniel Patrick Moynihan and Bob Kerrey makes considerably larger reductions in the Social Security cost-of-living adjustment than do H.R. 4824 and S. 2313. Under the Moynihan-Kerrey plan, Social Security benefits would be adjusted each year by the CPI minus one full percentage point. Since disabled beneficiaries and the survivors of workers who die well before retirement age often receive benefits for a longer number of years than retirees do, this reduction in the cost-of-living adjustment would reduce their benefits substantially.

At the same time, the Moynihan-Kerrey plan does *not* contain the change in the basic Social Security benefit formula (i.e., the changes in how the primary insurance amount is calculated) that H.R. 4824 and S. 2313 include. As a result, the *overall* reduction in disability and survivors benefits is smaller under the Moynihan-Kerrey plan than under H.R. 4824 and S. 2313. The Moynihan-Kerrey plan does not need as large Social Security benefit reductions as H.R. 4824 and S. 2313 do because, over time, it diverts much less payroll tax revenue from the Social Security trust funds to individual accounts than H.R. 4824 and S. 2313.

A third plan, fashioned by former Social Security Commissioner Robert Ball, would result in small effects on disability and survivor benefits. The Ball plan modestly lowers the cost-of-living adjustment by requiring the Bureau of Labor Statistics to update every three years, rather than every 10 years, the market basket of goods and services on which the CPI is based. The expected impact of this aspect of the Ball plan on the Social Security cost-of-living adjustment would about the same as the expected impact of the cost-of-living provision of H.R. 4824 and S. 2313. The Ball plan contains no other provisions that have substantial effects on disability or survivors benefits. (The Ball plan contains much smaller Social Security benefit reductions than the Moynihan-Kerrey or NCRP proposals both because it does not divert any trust fund revenues to individual accounts and because it closes a little more than half of the 75-year Social Security financing gap by investing up to half of Social Security reserves in the equities markets and securing higher returns for the Social Security trust funds through this mechanism.)

Another plan that could affect disability and survivors benefits is a plan that Senator Phil Gramm has developed but not yet formally introduced. The Office of the Chief Actuary of the Social Security Administration has analyzed the Gramm plan, which is derived from a proposal by Harvard economist Martin Feldstein. The actuaries found that the revenue the Gramm plan allocates for Social Security disability benefits and benefits for survivors of workers who die before reaching retirement age would be insufficient. The amount that the plan allocates for these benefits is only about two-thirds of the amount the actuaries estimate would be needed to finance these benefits.<sup>12</sup> The consequences of this shortfall are unclear, but the shortfall would appear to place disability and survivors benefits at some risk unless a future Congress were willing to redirect some of the resources going into individual accounts back to the Social Security trust funds or to raise Social Security payroll taxes, the Social Security disability insurance program would face a financial crunch that could lead to significant reductions in it.

<sup>12</sup> Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Considerations in Evaluating the 'Social Security Preservation Act' Proposed by Senator Phil Gramm," April 27, 1998.

provision would protect some retired, disabled and survivor beneficiaries from part or all of the benefit reductions they otherwise would face under this legislation.

Under this provision, workers who become eligible for Social Security benefits after working a minimum of *two* quarters each year between the year in which they turn 21 and the year they become disabled or die are guaranteed a minimum Social Security benefit equal to at least 60 percent of the 1996 poverty line for a single individual, adjusted for inflation. In 1998, this would equal a monthly benefit of \$400. A worker who has worked *four* quarters each year between turning 21 and the year he or she becomes disabled or dies would be guaranteed a minimum benefit equal to 100 percent of the 1996 poverty line for a single individual, as adjusted for inflation.<sup>14</sup> (The 1996 poverty line for a single individual would be adjusted by the Social Security CPI each year through 2009, and by average wage growth in years after that, to determine the poverty line figure used in computing a beneficiary's minimum benefit.<sup>15</sup>)

This provision would have a substantial impact on the benefits available to workers who earned very low wages and had strong labor force attachment. If the provision were in effect today, a worker who earned low wages before becoming disabled and who qualified for a minimum benefit equal to 100 percent of the poverty line would be guaranteed a minimum benefit of \$666 a month in 1998. This equals the monthly benefit level that a worker who has earned an average of \$14,600 per year before becoming disabled would receive under current law.

As a result, workers who worked four quarters each year between age 21 and the onset of their disability and who earned average wages of less than \$14,600 would

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<sup>14</sup> The minimum benefit provision also applies to retirees. Retirees would be eligible for a minimum benefit equal to 60 percent of the poverty line if they had worked at least 20 years and to a minimum benefit equal to 100 percent of the poverty line if they had worked at least 40 years. For retirees, the disabled, and survivors alike, once the benefit level of an individual receiving the minimum benefit has initially been set, the benefit would be adjusted for inflation in subsequent years by the Social Security CPI, just as all other Social Security benefits would be.

<sup>15</sup> Between enactment of the legislation and 2009, the minimum benefit would equal modestly less than 60 percent to 100 percent of the poverty line, due to use of the Social Security CPI rather than the regular CPI to adjust the 1996 poverty line for a single individual. The Census Bureau adjusts the poverty line each year in accordance with the regular CPI; the Social Security CPI would rise more slowly than the regular CPI. After 2009, the poverty line figure used to calculate the minimum benefit would be adjusted by average wage growth, rather than by the Social Security CPI. Average wages are expected to rise somewhat faster than the regular CPI since they generally have done so in the past. This means that the minimum benefit eventually would be set somewhat higher than 60 percent to 100 percent of the poverty line.

receive higher benefits than under current law.<sup>16</sup> The same would be true for survivors of deceased workers who had a strong labor force attachment and earned average wages of less than \$14,600.<sup>17</sup>

This provision would not benefit low earners with substantial periods out of the labor market before becoming disabled or dying, such as some women who lose some years of employment due to child-rearing or some individuals who experience a prolonged period of unemployment due to an economic downturn and become disabled or die fairly soon thereafter.

### **Finding a Solution: No Easy Answers**

In theory, the disability and survivors benefits of most disabled and survivor beneficiaries (including those not shielded by the proposed minimum benefit) could largely be protected from benefit cuts when Social Security retirement benefits are reduced. This could be done by exempting the calculation of survivors and disability benefits from the various changes in the formulas used to calculate Social Security retirement benefits.

In practice, however, using different formulas to calculate Social Security disability and survivors benefits from the formula used to calculate retiree benefits would lead to a highly inequitable distribution of benefits. Under current law, benefits are directly related to a worker's past wages. Most workers who do not collect Social Security until retirement receive a higher monthly benefit than do disabled and survivor beneficiaries, since workers who do not collect benefits until retirement have spent more years in the labor market and typically have seen their earnings rise over time. This would no longer be true if disability and survivors benefits were held harmless while retirement benefits were reduced substantially. If that occurred, a disabled beneficiary could receive substantially higher benefits than a retiree.

For example, if changes are made to the calculation of retirement benefits but disability and survivors benefits continue to be calculated as under current law, a worker who becomes disabled at age 61 would retire with unreduced Social Security

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<sup>16</sup> Under Social Security law, a worker does not have to work every quarter of the year to receive credit for four quarters of work for the year. A worker who earns \$700 in a year is credited with one quarter of work. A worker who earns at least \$2,800 in the year is credited with four quarters for that year. These earnings levels are indexed for inflation.

<sup>17</sup> The minimum benefit provision of the NCRP plan also flattens Social Security benefits across the lower part of the wage scale. Workers who had enough quarters of work to receive the minimum benefit and whose average indexed earnings over their work careers were between \$2,760 and \$19,000 on an annual basis (measured in 1998 dollars) would all receive the same Social Security benefit level.

### **Implications of Individual Account Plans for the Financing of Benefits for Disabled Workers**

The benefits of disabled workers are financed through the Social Security Disability Insurance (DI) trust fund only until workers reach the age of 65. At that point, although the workers' benefit levels remain unchanged, their benefits are financed through Social Security's other trust fund, the Old Age and Survivors Insurance (OASI) trust fund. Any Social Security reform plan that replaces some portion of Social Security retirement benefits with private accounts must take this into consideration, as the Social Security benefits of disabled workers who reach retirement age will still have to be financed through the OASI trust fund. Such a plan must provide adequate resources for the OASI trust fund to fulfill this task. This matter is of particular importance because the individual accounts of workers who become disabled well before retirement age will not have accumulated sufficient funds to provide much supplemental income.

benefits while also having accumulated a significant individual account from which to draw supplementary income. Meanwhile, a worker with a similar earnings history who retired at age 65 could have a similar-size individual account but sharply reduced Social Security retirement benefits. The two beneficiaries would have very different total benefit packages, even though both left the labor market within a few years of each other. Such an inequitable structure could prompt a significant number of individuals to leave work earlier and attempt to claim disability benefits.

At the same time, if the disability benefit calculation is *not* held harmless while benefit changes such as those in H.R. 4824 and S. 2313 are made, a worker who becomes disabled at a relatively young age would not have much of an individual account to draw upon and could face sharply reduced overall benefits.

In short, changing the calculation of Social Security retirement benefits in the manner that H.R. 4824 and S.2313 do either would result in large reductions in Social Security benefits — and overall income — for many disabled beneficiaries and survivors or would introduce substantial new inequities into the Social Security system.

The drafters of the legislation based on the NCRP plan recognized these complexities. They included a provision in their bills that would allow for later changes to be made in the disability insurance program. Under this provision, the Social Security Board of Trustees, in consultation with the National Council on Disability, would be required to submit to Congress and the President recommendations for statutory adjustments in the disability insurance program by May 31, 2001. H.R. 4824 and S. 2313 state that these recommendations may address such issues as the adequacy of benefits, the relationship of disability benefits to retirement benefits, and the process for determining initial eligibility and continued eligibility for the disability program. If the President approved the recommendations, the President

would submit them to Congress for consideration. The bill specifies procedures for resolving differences between the President and the Board if the President does not approve the Board's recommendations. It also requires that the recommendations be provided to Congress within a specified period of time if the Board and the President continue to disagree.

While this provision establishes a mechanism for consideration of possible changes in disability benefits, the fact remains that the disability benefits these bills would write into law would represent substantial reductions from the benefits that current law provides. It would take enactment of subsequent legislation to reverse these reductions.

Moreover, any recommendations to improve disability benefits submitted through this process would have to be made "...without reducing the balance ratio of the Federal Disability Insurance Trust Fund." This means the total cost of the Social Security Disability Insurance program could not increase. Any increases in restorations in Social Security disability benefits for some beneficiaries would have to be matched by offsetting reductions in Social Security disability benefits for other beneficiaries.

In addition, the Social Security trustees and other individuals who would be charged with considering and making recommendations regarding possible changes in disability benefits would face the same dilemma that the authors of H.R. 4824 and S. 2313 confronted; were it possible to shield disability benefits from the large cuts H.R. 4824 and S. 2313 make without introducing serious inequities and perverse incentives into the Social Security system, the authors of these bills would have done so. As the original NCRP report indicated, it was NCRP's goal to avoid such reductions in disability benefits. For these reasons, the provision of H.R. 4824 and S. 2313 calling for the submission of recommendations regarding disability benefits cannot be regarded as a safety clause that would ensure cuts in disability benefits are restored.

Finally, this provision would apply only to disability benefits. The legislation does not contain a similar provision establishing a mechanism for developing recommendations to ease the reductions in Social Security benefits provided to survivors of workers who have died before retiring.

## **Conclusion**

Under the Social Security benefit structure, the formulas used to determine disability and survivors benefits are intertwined with the formula for determining retirement benefits. If Social Security retirement benefits are reduced substantially, as they generally would be under plans that shift a portion of payroll tax revenues from

the Social Security trust funds to individual accounts, disability and survivors benefits are likely to be reduced substantially as well.

The legislation based on the proposal developed by the National Commission on Retirement Policy illustrates this problem. Commission members intended and desired that disability benefits not be reduced as a result of their plan. But despite their efforts and intentions, they were unable to fashion their plan in a manner that would avert substantial reductions in the basic monthly benefits on which many disabled workers and survivors of deceased workers depend.

THE WHITE HOUSE  
WASHINGTON

To: Gerben DeJong, PhD; Howard Goldman, MD; Ed Yelin, PhD; Marilyn Moon, PhD; Joshua Weiner, PhD; David Stapleton, PhD; Monroe Berkowitz, PhD  
From: Jonathan M. Young, Office of Public Liaison  
RE: Social Security and Medicare Meeting  
Date: March 1, 1999

Thank you for your interest in discussing the President's Social Security and Medicare proposals, particularly as they relate to concerns of people with disabilities. Attached please find background materials about the President's plan. I have provided a brief agenda below. If you wish to attend in person (preferable), I will need your Social Security number and date of birth for Secret Service clearance in advance. I can be reached by phone (202) 456-7032 or by fax (202) 456-6218.

I view this meeting as the beginning of an ongoing dialogue, with a first goal of identifying technical questions for the National Economic Council, Treasury Department, and Social Security Administration. Following this meeting, I will put your questions/comments in writing and then schedule a follow-up meeting with Administration staff.

**Agenda for Social Security/Medicare Discussion**

**Date:** Tuesday, March 2, 1999

**Time:** 2:30 PM, EST

**Place:** Room 211, Old Executive Office Building (enter at 17th and G Streets or Penn. Ave.)

**Call-in:** (202) 456-6799, enter code 5692

**I. Introductions**

**II. Overview of the Office of Public Liaison (Young)**

**III. Overview of Social Security and Medicare Proposals (Young)**

**IV. Discussion of Administration Proposals**

**V. Identification of Technical Questions for Follow-up Meeting**

**VI. Discussion of Possible Times and People for Next Meeting**

**VII. Adjourn (4:00 PM at the latest)**

**PRESIDENT CLINTON'S FRAMEWORK:  
SOCIAL SECURITY AND MEDICARE REFORM--MAINTAINING FISCAL DISCIPLINE**

**I. ADMINISTRATION PROPOSAL**

- General Overview
- Summary of the President's Proposal
- Benefits of Debt Reduction
- Talking Points on Double Counting Issue
- The Case for Investing in Equities

**II. CHARTS AND GRAPHS**

- Pie Chart: Use of Unified Surplus
- Pie Chart: Interest Payments Due on Debt
- Graph: Publicly Held Debt, 1980-2014

**I II. COMMENTARY ON ADMINISTRATION PROPOSAL**

- Support for Key Aspects of President Clinton's Proposal
- David S. Broder, "The Greatest Gift to our Kids," *The Washington Post*
- Jacob M. Schlesinger, "Greenspan Backs Clinton's Plan for the Surplus," *The Wall Street Journal*
- Jonathan Chait, "Washington Diarist: Doubletalk," *The New Republic*

**GENERAL OVERVIEW:**  
**PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM,**  
**WHILE MAINTAINING FISCAL DISCIPLINE**

- **Investing the Surplus for Tomorrow: The President's Plan Reserves Nearly 90% of Surplus To Meet Long-Term Retirement Challenge.**
  - Rather than consuming the surplus for today, President Clinton's proposal reserves nearly 90 percent of the projected budget surpluses --almost \$4 trillion --over the 15 years to meet our long-term retirement challenge; 62% of the surpluses are reserved for Social Security, 15% for Medicare, and 12% for USA Accounts.
  - President Clinton's proposal will pay down nearly \$3 trillion of our national debt. As a result, the publicly held debt will be cut by more than two-thirds and, as a share of GDP, will fall from 44 percent today to 7.1 percent in 2014 --its lowest level since 1917.
- **Continuing A Pro-Growth Strategy That is Working vs. Returning To The Failed Policies of Debt and Deficit: The President's Proposal Creates a Debt Reduction Lock-Box for Social Security and Medicare.**
  - In 1993, President Clinton and Congressional Democrats cut the deficit, helping create the longest peacetime economic expansion in history. President Clinton's plan will create a debt reduction lock-box for Social Security and Medicare. This is a pro-growth strategy --maintaining fiscal discipline by cutting the national debt, which will result in higher national savings, lower interest rates, higher private-sector investment, and higher economic growth. We should not return to the failed policies of the 1980s that quadrupled the national debt and led to the highest deficit in the history of our country.
- **President Clinton Believes We Must Meet Obligations To Future Generations First --By Reserving 77% of Surpluses for Saving Social Security and Strengthening Medicare.**
  - Republicans and Democrats agree that investing 62 percent of the surplus to strengthen Social Security is the right thing to do. Some --even those who agree we should save Social Security --would use the rest of the surplus for tax cuts. President Clinton believes we must meet our obligations to future generations first --that is why must reserve 77 percent of the projected surpluses to save Social Security and strengthen Medicare. The President believes that anyone who hopes

to spend the surplus --on tax cuts or spending initiatives --has an obligation to first tell America's families how they plan to preserve and extend the Medicare trust fund into the next century.

- **After We Save Social Security and Strengthen Medicare, We Should Provide Tax Relief for America's Families: President Clinton's Plan To Give Tax Credits for Retirement Savings in USA Accounts Will Mean Larger Tax Relief for Average Families Than The Republican Plan.**
  - The Republican tax scheme would disproportionately help the rich. According to the Citizens for Tax Justice, for the one percent of taxpayers making more than \$301,000, the average tax cut would be \$20,697 annually. But, for taxpayers making less than \$38,000, a group that includes 60% of all taxpayers, the average tax cut under the Republican proposal would be \$99 a year --far less than the hundreds of dollars for average working families the President's USA Account proposal would provide.

**PROPOSAL SUMMARY:**  
**PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM,**  
**WHILE MAINTAINING FISCAL DISCIPLINE**

**In His State of the Union Address, President Clinton Put Forward His Framework To Save Social Security and Strengthen Medicare, While Meeting America's Challenges for the 21st Century.** The President and Vice President's framework strengthens Social Security and Medicare by:

- **Using The Budget Surplus To Help Save Social Security And Invest A Portion In the Stock Market To Seek Higher Returns.** The President proposes to transfer 62 percent of the projected budget surpluses over the next 15 years --\$2.8 trillion --to the Social Security system. The President proposes to invest less than one-quarter of the transferred surpluses in the private sector to achieve higher returns for Social Security --just as any state or local government, or private pension does --after working with Congress to devise a mechanism to ensure that the investments are made independently and without political interference by private-sector managers with minimum administrative costs.
- **This Framework Will Save Social Security Until 2055 --And the President Will Work With Congress To Save It Until At Least 2075.** Transferring over 60 percent of the surpluses to Social Security and investing a portion in the market will keep Social Security solvent until 2055. The President believes we must work on a bipartisan basis to make the hard-headed but sensible and achievable choices to save Social Security until at least 2075. As part of this effort, President Clinton believes that we must:
  - (1) ***Reduce Poverty Among Single Women.*** Reduce poverty among elderly women --particularly widows, who have a poverty rate nearly twice the overall poverty rate for older Americans; and
  - (2) ***Eliminate The Earnings Test.*** Eliminate the confusing and out-dated earnings test so that we stop discouraging work and earnings among older Americans.
- **Strengthen Medicare for the 21st Century.** The President's framework reserves 15 percent of the projected surpluses for Medicare, securing Medicare until 2020. The President believes that the new resources should be utilized to achieve broader, bipartisan reforms that modernize Medicare, make it more efficient, provide for a long-overdue prescription drug benefit, and keep Medicare safe until 2020.

**After Social Security and Medicare Reform Are Secured, President Clinton Proposes To:**

- **Provide \$536 Billion in Tax Credits to Create New Universal Savings Accounts --USA Accounts.** The President's framework will reserve 12 percent of the projected surpluses to create new Universal Savings Accounts (USAs) so working Americans can build wealth to meet their retirement needs. To help Americans save, we would provide Americans a flat tax credit to make contributions into their USA account. In addition, we would provide additional tax credits to match a portion of an individual's savings --with more help for lower-income workers.
- **Prepare America for the Challenges of the Future.** The President's framework will reserve 11 percent of the projected surpluses for military readiness and other pressing domestic priorities.

**A FISCALLY RESPONSIBLE PROPOSAL:  
PUBLICLY HELD DEBT FALLS TO LOWEST LEVEL SINCE 1917**

- **Debt-to-GDP Ratio Will Fall to Lowest Level Since 1917.** As a share of the economy, the publicly held debt increased from 26% in 1981 to 50% in 1993. Since President Clinton took office, the publicly held debt as a share of GDP has dropped to 44%. And under the President's framework, the publicly held debt will be cut by more than two thirds, and, as a share of GDP, will fall from 44% today to 7.1% in 2014 --its lowest level since 1917.

**BENEFITS OF DEBT REDUCATION:  
A PRO-GROWTH STRATEGY  
THAT CUTS THE FEDERAL DEBT TO ITS LOWEST LEVEL SINCE 1917**

**In the 1980s, The Federal Debt Quadrupled.** Under Presidents Reagan and Bush, the debt held by the public quadrupled. As a share of GDP, the publicly held debt increased from 26 percent in 1981 to 50 percent in 1993. When the President took office, the debt-to-GDP ratio was projected to rise to nearly 80 percent by 2003.

**Under President Clinton, America's Fiscal House Is Now In Order.** Instead of sticking with the failed policies of debt and deficit, President Clinton put in place a bold, new economic strategy to cut the deficit, lower interest rates and spur economic growth. Today, we have the first budget surplus in a generation.

**President Clinton's Proposal Will Cut Debt To Lowest Level Since 1917.** As a result of President Clinton's fiscal discipline, the publicly held debt as a share of GDP has dropped from 50 percent in 1993 to 44 percent in 1998. Under the President's framework, the publicly held debt will be cut by more than two thirds and, as a share of GDP, will fall from 44 percent to 7.1 percent in 2014 --its lowest level since 1917.

**President Clinton's Strategy To Cut the Debt Will Help Strengthen the Economy, Cut Interest Payments, and Ensure that We Do Not Leave A Legacy of Debt to Our Children:**

- **President Clinton's Strategy Is A Pro-Growth Strategy.** President Clinton's framework will cut the federal debt, thereby raising national savings by nearly 2 percent of GDP; Universal Savings Accounts will encourage saving even more. Higher national savings will mean lower interest rates, higher private-sector investment, and thus, higher economic growth in the future.
- **President Clinton's Strategy Will Cut Interest Payments on the Federal Debt.** When President Clinton took office, interest payments on the federal debt were projected to eat up 27 cents of every budget dollar by the year 2014. That would have made it almost impossible for future generations to make basic decisions about how the government should spend their money. Today, interest payments on the debt take up about 13 cents of every tax dollar. *Under the President's proposal, interest payments would shrink to just 2 cents on every dollar by 2014.*
- **President Clinton's Strategy Will Ensure That We Do Not Leave a Legacy of Debt to Our Children.** President Clinton's proposal would cut the debt held by the public, as a share of the economy, to 7.1 percent in 2014. This would mean that instead of leaving a

mountain of debt for our children, we would completely eliminate the national debt by 2018.

#### **CUTTING THE NATIONAL DEBT IS RIGHT FOR AMERICA**

- **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** “[I]ncreasing our national saving is critical. The President’s approach to Social Security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government’s positive contribution to national saving is sustained.”
- **David Broder, “The Greatest Gift to our Children,” *Washington Post*, February 7, 1999:** “[Saving on interest payments due on the national debt] illustrates the single biggest achievement -- and the most important virtue -- of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future. Thanks to the budget decisions he has made -- some fiercely resisted by Republicans and others urged or embraced by them -- we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses. This is a huge gain for ourselves and our children.”

## TALKING POINTS ON DOUBLE COUNTING AND DEBT

- **When You Strip Away All of the Accounting Rhetoric, the President's Plan Does Two Things:**

- (1) Between now and 2014, the President's plan will cut the publicly held debt by more than two thirds, increasing national savings and strengthening our economy to make it easier for us to meet our retirement challenge and other national priorities.

- (2) It gives Social Security first claim on the benefits of debt reduction (by giving new bonds to the trust fund).

- **That Is Why Fed Chairman Alan Greenspan and Top Experts Support the President's Approach to Debt Reduction:**

- **Henry Aaron, Brookings Institution, January 27, 1999:** "The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases."
  - **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."

- **The President's Plan Takes Advantage of Our Current Good Times to Set Aside Resources So That We Can Meet Our Existing Obligations.** We already have an obligation to current workers to pay them benefits when they retire, even if they retire in years after 2032. The President's plan does not increase these commitments. Instead, it sets aside resources so that we can meet our existing obligations.

- **Under the President's Plan, We Have the Ability to Pay Benefits Through 2032 and Beyond.** When President Clinton took office in 1993, deficits were exploding and there were serious concerns about how we were going to be able to pay back the Social Security trust fund when it began redeeming its bonds. Because of the fiscal discipline and tough choices of the past six years, the Clinton Administration is projecting budget surpluses, even after paying back Social Security, until the middle of the next century.

- **The President's Plan Follows the Same Accounting That Has Been Used by Every U.S. Administration since the Johnson Administration.** Since the Johnson Administration, the Social Security surplus has been part of the unified budget surplus, and has been used a second time, almost always for new spending. Many Republicans have called for the surplus to be used a second time for tax cuts, to fund individual accounts, or to pay for the transition to an individual account system. The President's plan uses the surpluses for debt reduction, and to extend the life of the Social Security and Medicare trust funds.
- **The Bottom Line Is Clear: The President's Plan Will Cut the Debt and Keep America's Economy Strong.** Regardless of any claims offered by opponents, the President's plan will cut the debt held by the public by more than two thirds, and as a share of the economy it will fall to its lowest level since 1917. This will raise national savings, lower interest rates, and help keep America's economy strong. The President's plan will lower the burden faced by our children and grandchildren, and leave the country better able to meet the challenges of an aging population.

## THE CASE FOR INVESTING PART OF THE UNIFIED SURPLUSES IN EQUITIES

In his State of the Union Address, the President proposed that 62 percent of the projected budget surpluses over the next 15 years be transferred to the Social Security Trust Fund, in order to increase the ability of that Fund to meet promised Social Security benefit obligations. The President further proposed that about a fifth of the transferred surpluses be invested in equities to achieve higher returns for Social Security, helping to extend the life of the Social Security trust fund to 2055. This action does, however, raise understandable concerns about the possible extension of political influence on investment decisions and the risks that this might pose to the economy and the Trust Fund. Any system of collective investment can and must address these concerns. That is why we will work with Congress to design a system that observes five core principles:

1. **Private Sector Managers Selected by Competitive Bidding.** Social Security beneficiaries deserve the same efficient management and market returns that people receive in their private pensions and personal savings. The actual investments should be managed by private sector money-managers selected by competitive bidding.
2. **Independently Managed and Non-Political.** There would need to be wholly independent oversight of investment that was insulated from political influence. The choice of investment managers should be done by an independent board whose sole responsibility would be to pick fund managers so as to maximize the performance of the investments. This would ensure that the investment of funds was carried out with zero government involvement.
3. **Limited.** The share of Trust Fund assets invested in equities ought to be kept at a very modest level --both to limit risk to the Fund and to ensure that collective investments never account for more than a small fraction of the stock market as a whole.
4. **Broad-based, Neutral, and Non-Discretionary.** Assets should be invested proportionately in the broadest array of publicly listed equities, with no room for discretion in adding or deleting companies and no room for active involvement in corporate decisions. Neither the government nor the private sector managers it selects to undertake investment on its behalf should be involved in "stock picking." As a shareholder the Funds should be entirely passive; one way to accomplish this would be to mandate that proxies be voted in the same proportions as other shareholders. Alternatively, if the investments were spread among a number of managers so that no one manager had a large share of the total market, the managers could vote the shares in the interests of the share holders, just as mutual fund managers do today.

- *No Market Timing or Stock Picking.* In essence, the managers should be on autopilot in investing the funds. They should have little or no discretion in the investment of Trust Fund assets --so they cannot “time the market” or pick individual stocks.
5. **Lowest-Cost.** Collective investment needs to be administratively simple and achieved at the lowest available cost --both to obtain the highest possible returns and to further enhance the system’s transparency and independence.

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| <b>WHY INVEST PART OF THE SURPLUSES IN EQUITIES?</b> |
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1. **Investing Part of the Surpluses in Equities Would Raise the Rate of Return That Workers Would Experience on Their Contributions into the Social Security System.**

- Historically, the Trust Fund has been invested exclusively in government bonds. While these bonds have the upside that they are essentially risk-free, they have the downside that they pay a relatively low rate of return on average. Adding equities to the Trust Fund portfolio would allow the Social Security system to enjoy a higher rate of return, on average. Between 1959 and 1996, the difference between the average annual rate of return earned on stocks and the rate earned on bonds held by the Trust Fund --the “equity premium” --was 3.84 percent.
- Raising the rate of return on the Trust Fund would mean that the Social Security system could be brought into long-term actuarial balance with smaller reductions in benefits, or smaller increases in revenue, or both.
- Investing part of the transferred surpluses in equities accounts for about one-third of the improvement in the actuarial balance achieved under the President’s framework.

2. **Investing Part of the Trust Fund in Equities Would Bring Social Security into Line with the “Best Practice” of Both Private-and Public-Sector Pension Plans.**

- The overwhelming number of private-sector defined-benefit pension plans invest part of their reserves in equities. Among large private-sector defined benefit plans (those with more than 100 participants), more than 40 percent of total assets of were invested in equities.
- Similarly, 65 percent of the portfolio backing the defined-benefit pension plan of the Federal Reserve System is invested in equities.
- In aggregate, state and local pension plans hold fully 10 percent of the overall stock market.

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| <p style="text-align: center;"><b>WHY IS EQUITY INVESTMENT BETTER UNDERTAKEN<br/>THROUGH THE TRUST FUND THAN THROUGH INDIVIDUAL ACCOUNTS?</b></p> |
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**1. Administrative Costs Associated with Trust Fund Investment Would Be Much Lower.**

- For example, the equity-fund component of the Federal Thrift Savings Plan (TSP) incurs annual investment-management costs of only about one basis point (one one-hundredth of a percentage point). Thus, for every \$100 in equity assets under management, the TSP pays only about one cent per year in management fees.
- By contrast, asset management fees for individual accounts such as IRAs typically run in the neighborhood of 100 basis points or more --or about \$1 per year for every \$100 under management.
  - *The asset management fees associated with IRAs are thus typically at least 100 times larger than the fees associated with centralized investment.*
- Management fees are extremely important in determining the buildup of assets. A fee of one basis point paid every year for 40 years would reduce the accumulated balance by only about 0.4 percent. By contrast, a fee of 100 basis points would reduce the accumulated balance by about 33 percent.

**2. Financial Risk Can Be Spread Much More Effectively If Equity Investment Is Undertaken Through the Trust Fund than Through Individual Accounts.**

- Financial risk that arises through equity-investment of the Trust Fund can be spread both across the entire population participating in the system at any given point in time, and over time. Indeed, provided equity investment is undertaken through the Trust Fund, the consequences of market fluctuations can potentially be spread over many generations.
- By contrast, in a system of individual accounts, the consequences of market fluctuations must --by definition --be borne by each individual. If the market happens to do well during a certain individual's lifetime, that individual can enjoy a relatively prosperous retirement. If the market does poorly, that individual's financial security in retirement may be jeopardized.

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| <p style="text-align: center;"><b>WHY CAN WE BE CONFIDENT THAT TRUST FUND<br/>INVESTMENT IN EQUITIES WON'T DISRUPT THE MARKET?</b></p> |
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**1. This Is Not Direct Government Investment --It Is Investment Undertaken by Private-Sector Managers Selected by Competitive Bidding.**

- A bedrock principle of the President's program is that the government itself should not be a participant in the market. All transactions will be executed by private-sector managers.
- The Thrift Savings Plan selects managers in a similar way, placing its portfolio with managers that bid the lowest cost. These managers also vote the shares of stock they control.

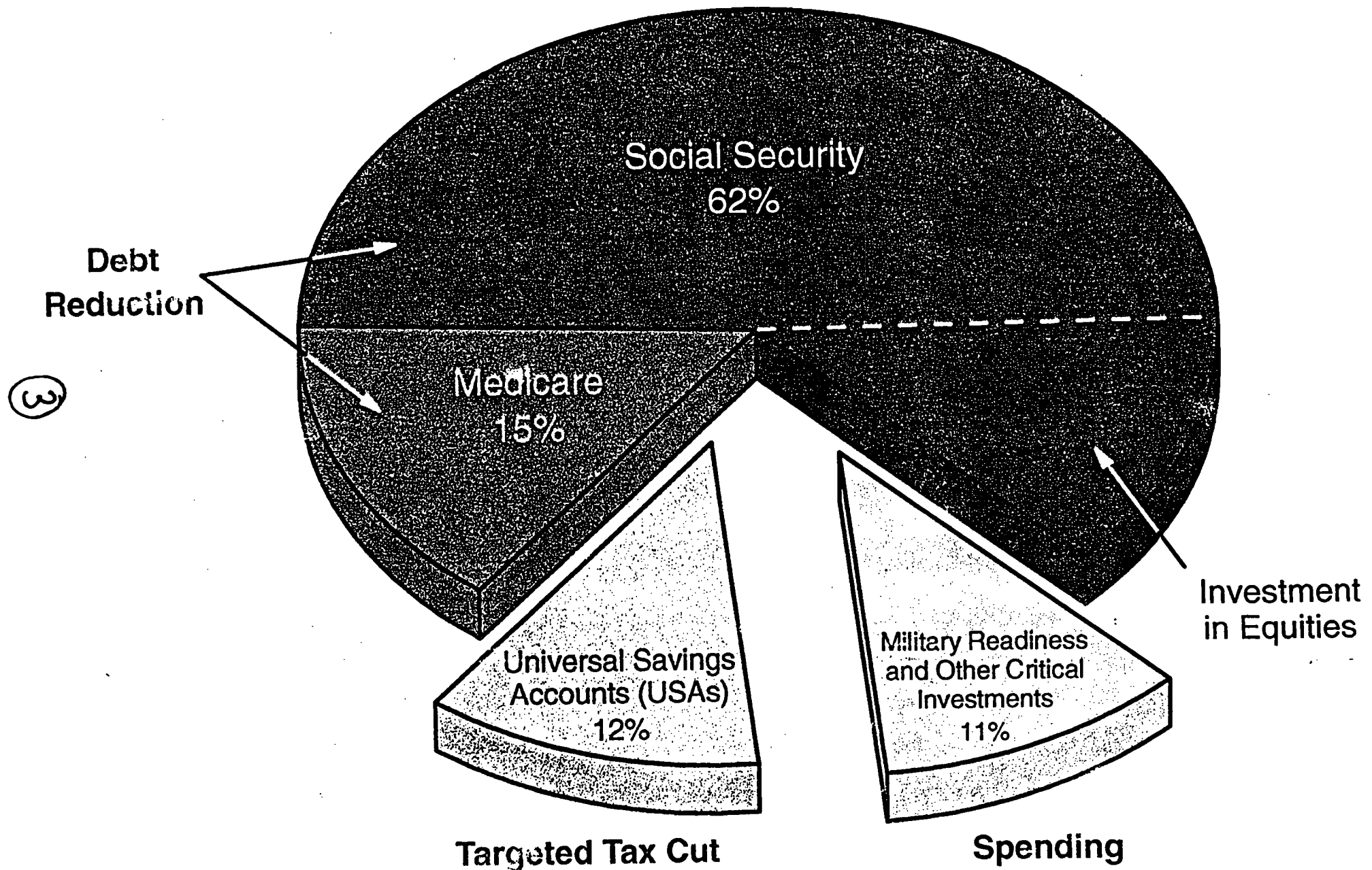
**2. Institutional Rules Can Be Established to Create Very Strong "Fire Walls" Against Political Interference.**

- The experience of state and local pension funds points to several elements of institutional design that have been essential in that context in helping prevent political interference.
- Investments can be made in a broad-based, neutral, and non-discretionary way. Through passive investing in an index, private-sector managers will not be involved in "stock picking."
- History shows that political influence can be avoided. The overwhelming bulk of assets in state and local plans are invested wisely --not in politically motivated ways.
- For example, the Federal Thrift Savings Plan (TSP) invests \$77 billion in stocks and bonds, with more than half in stocks. Francis Cavanaugh, the first executive director of the Board responsible for TSP investments, says that investments have been made without political interference. Specifically, in a recent news article, Cavanaugh said, "Can it be done? It's been done... We did it."

**3. The Equity Holdings of the Social Security System under the President's Program Would Be Modest Relative to the Holdings of Other Major Players in the Market.**

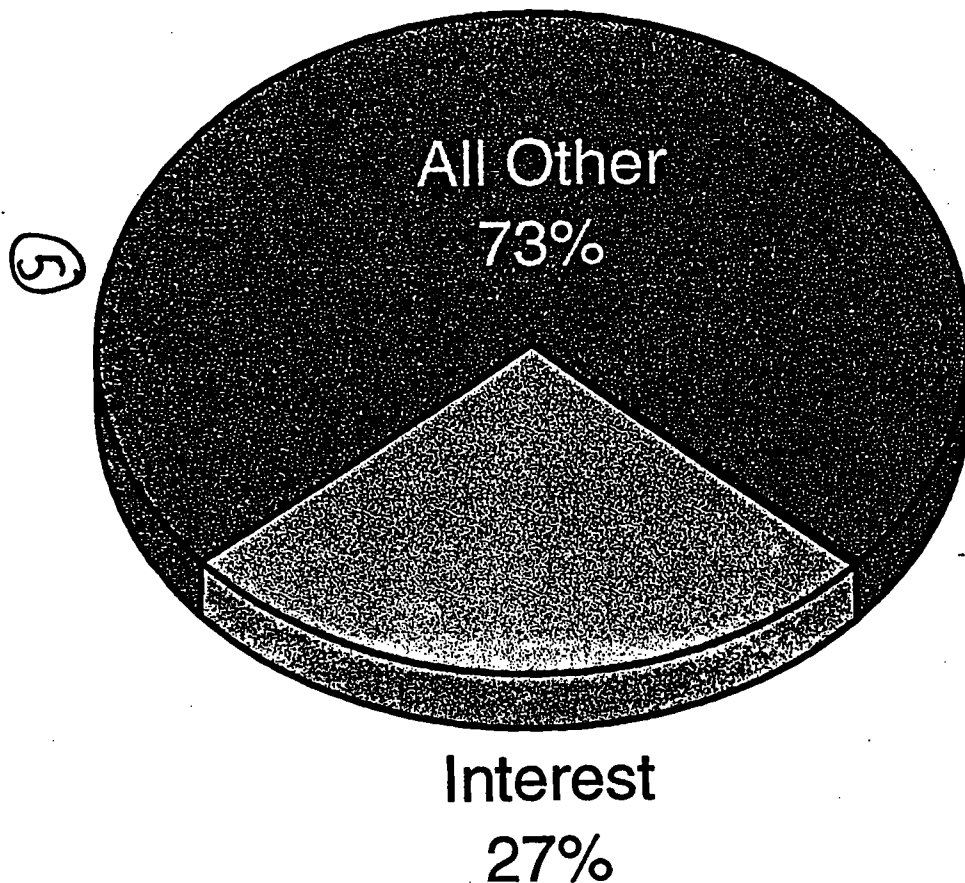
- Under the President's program, the Social Security system would hold an average of about 4 percent of the aggregate U.S. stock market.
- The top 10 largest private-sector portfolio managers all have more than one percent of the market under management. Fidelity, the largest such private-sector manager, has about 4 percent of the market under its management.
- By contrast, state and local governments in aggregate already hold about 10 percent of the market.

# Framework for Social Security and Medicare Reform with Long-Term Fiscal Discipline

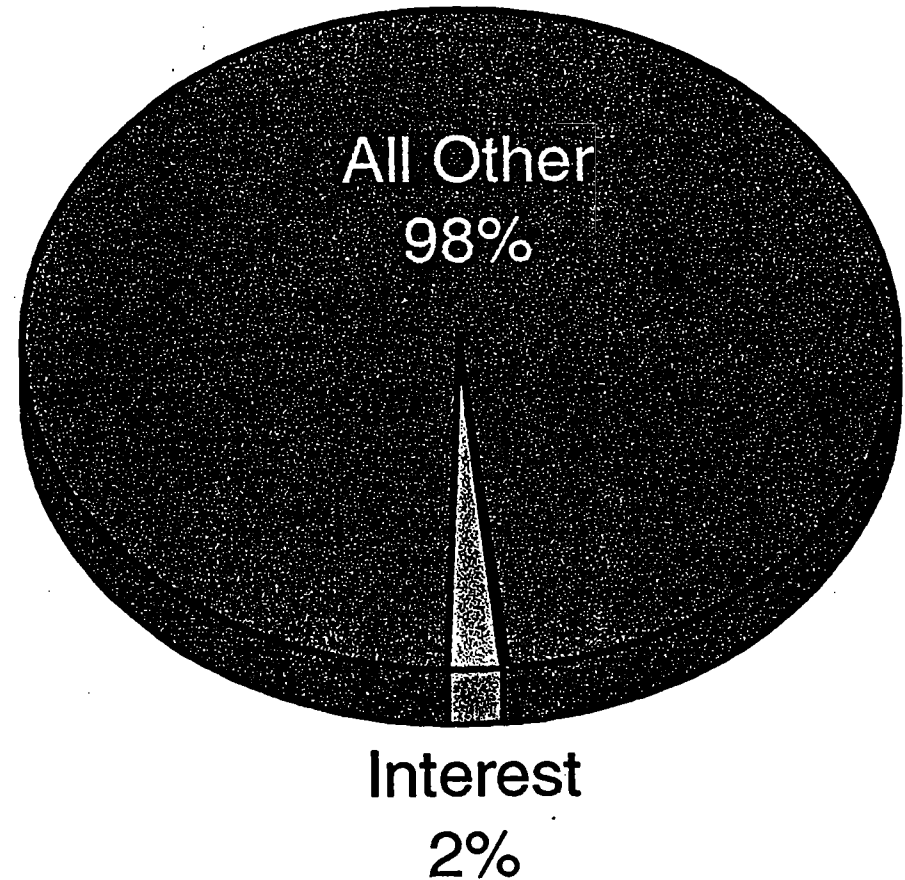


# Interest as a Percent of Outlays in 2014

Pre-1993 Baseline

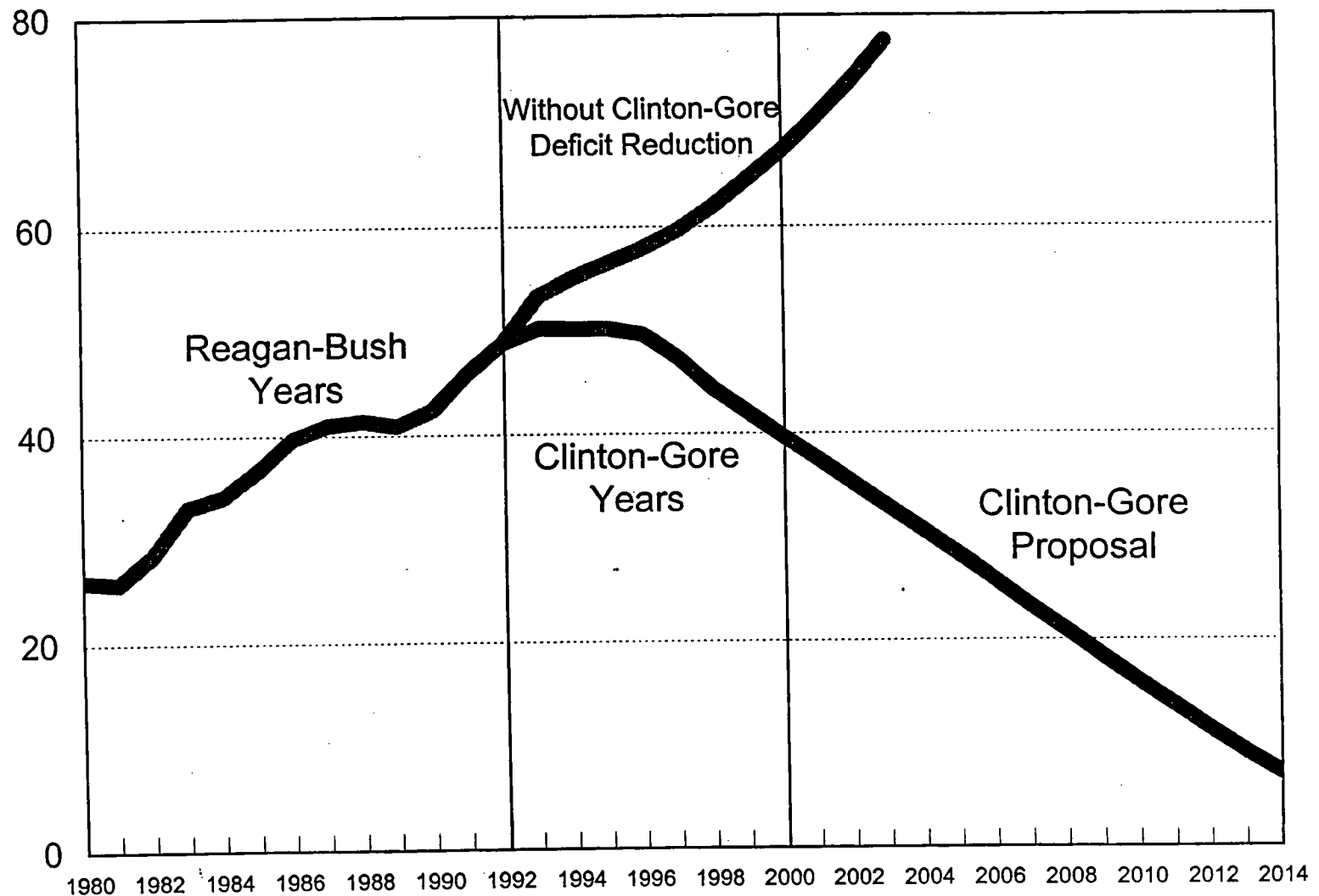


President's Proposal



# Investing The Surplus For Our Future: Cutting the Debt By More Than Two-Thirds

Ratio of Debt Held by Public to GDP  
(End of Fiscal Year)



## SUPPORT FOR KEY ASPECTS OF PRESIDENT CLINTON'S PROPOSAL

- **Henry Aaron, Brookings Institution, January 27, 1999:** "The purpose of this note is to explain how the president's proposal would work from an accounting perspective. The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases. Faced with a once in-a-generation choice about how to spend large and unanticipated surpluses, the nation should confront the big issue "save the surplus or spend it" and not get mired in accounting pettifoggery."
- **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."
- **Wall Street Journal, "Greenspan Backs Clinton's Plan For the Surplus: Diverting General Revenues Toward Social Security Will Cut Debt," January 29, 1999:** "Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.... Mr. Greenspan called Mr. Clinton's plan for the surplus 'a major step in the right direction.'"
- **New York Times, "In the Red. No, Black. Debate Over Social Security Proposal Misfires in Focus on Double Counting," January 30, 1999:** "[T]he real difference between the President's plan and that of his critics is not double counting. Some critics want to use the surplus to cut taxes. Many Republicans want to use it to create individual retirement accounts.... The President wants instead to drive down the Federal debt, now about \$4 trillion."
- **Washington Post, "Saving Budget," February 2, 1999:** "The government's long-run obligations continue to be much greater than the foreseeable revenues. The mostly conservative fiscal position that the president has staked out is correct."
- **Jonathan Chait, "Who's Fiscally Responsible Now," New York Times, January 25, 1999:** "The political genius of Mr. Clinton's plan is that it marries good policy with good politics. This used to be what Republicans called responsible budgeting. How sad that they now see it as unacceptable."

David S. Broder

# The Greatest Gift to Our Kids

A year ago, when President Clinton offered his federal budget, the estimate of fiscal 1999 interest payments on the national debt was a bit under \$242 billion. Last week, one-third of the way through that fiscal year, the new budget estimated interest payments at just over \$227 billion.

The almost \$15 billion saving resulted from two things: a marvelous economy that generated more revenues for Uncle Sam than had seemed likely. And, second, the decision—urged by Clinton and endorsed last year by Congress—to save about 80 percent of the resulting budget surplus and use it to pay down the national debt, thereby reducing interest payments.

Now, saving \$15 billion may not seem like much in a budget of \$1.7 trillion. But let me tell you, it is equal to the whole 1999 budget of the National Institutes of Health, our pre-eminent medical research facility. It is more than the federal government will spend this year on Head Start and the main program of assistance to elementary and secondary schools. It is more than is budgeted for all of the environmental, conservation and land management programs of the government.

This illustrates the single biggest achievement—and the most important virtue—of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future.

Thanks to the budget decisions he has made—some fiercely resisted by Republicans and others urged or embraced by them—we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses.

This is a huge gain for ourselves and our children. In a time of rampant cynicism about government and politicians, this is one achievement for which Washington can take a bow. To be sure, the real heroes and heroines are in the private economy, but politicians made hard decisions to restrain spending and resist huge tax cuts, without which these numbers would not have appeared.

For years, I wrote each February about "the fastest-growing item in the federal budget—interest payments on the national debt." I argued that this was the most wasteful of all expenditures, because those interest payments, drawn from current taxes, bought us not a single weapon or school lunch. It was money down the drain—or, more accurately, into the pockets of the bondholders, foreign and domestic.

And I often quoted Sen. Pat Moynihan of New York, who regularly warned that as long as these deficits piled on each other, year after year, interest costs would "rise geometrically," threatening the well-being of future generations.

But now we have broken out of that destructive pattern and entered into what Jack Lew, the director of the Office of Management and Budget, calls "a virtuous cycle." By saving the surplus and paying down the accumulated national debt, we reduce annual interest charges at an accelerating rate.

Here's an example. The budget submitted a year ago estimated interest costs for the following five years (fiscal '99 through '03) at \$1.159 trillion. The new budget estimates interest charges for the next five years (fiscal '00 through '04) at \$977 billion—a difference of \$182 billion. That's enough to pay the salaries of everyone in the military for half that five-year period.

In the first year, the saving is \$26 billion; in the fifth year, almost twice that, \$48 billion. And it will continue to grow each year.

Now, I am not confident of long-term projections, because no one knows when we will hit an economic squall. But Lew told the Senate Budget Committee that if we stayed the course for 15 years, the national debt would shrink from half the size of the whole economy—which it was in 1992—to about 7 percent of the economy's size. Freeing them of the burden of debt would be, he rightly said, "one of the greatest gifts that we could ever give our children."

The Republican response is to divert much of the surplus into a 10 percent, across-the-board tax cut. Sen. William Roth of Delaware, the chairman of the Finance Committee, told Treasury Secretary Robert Rubin, "I find it incomprehensible that the president's plan would not allow for a wide-gauge tax cut in the next 15 years."

Rubin replied that the Treasury estimates that 35 percent of the benefits of such a tax cut would go to the top 1 percent of earners and two-thirds of the benefits to the top 20 percent—"the upper-income people who are, in all other respects, doing best in our society."

That's the essence of the budget debate: Save the surplus for our kids or let the rich spend more on themselves.

THE WASHINGTON POST  
SUNDAY, FEBRUARY 7, 1999

# Greenspan Backs Clinton's Plan For the Surplus

## Diverting General Revenues Toward Social Security Will Cut Debt, He Says

By JACOB M. SCHLESINGER  
Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security, suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.

Republicans have stepped up criticism of the White House Social Security plan in

### Internet Exuberance?

Fed Chairman Greenspan told Congress that Internet-stock mania is like buying lottery tickets. Article on page C1.

recent days, focusing on its reliance on a massive transfusion of new tax revenues to extend the Social Security trust fund by 23 years to 2055. Currently, Social Security is funded by payroll taxes.

At a Senate Budget Committee hearing, Chairman Pete Domenici of New Mexico blasted Mr. Clinton's plan as "an elaborate game" of "accounting shifts" that will "undercut efforts to achieve real reform." Mr. Domenici noted that in prior bipartisan studies of the retirement program, one of the few points of consensus was opposition to using general revenues.

But Mr. Domenici and other Republicans were unsuccessful in repeated attempts to draw Mr. Greenspan into attacking Mr. Clinton's plan. Mr. Greenspan has in the past opposed using general revenues to fund Social Security and indicated yesterday that he wasn't happy about the idea now. But he implied that Mr. Clinton's plan—which essentially marries future Social Security commitments to current budget surpluses—may be the best political means to an end that Mr. Greenspan strongly supports: paying down the national debt of \$3.8 trillion held by the public.

The notion that Congress could rally enough support to pay down debt without such a gimmick "may be totally unrealistic," Mr. Greenspan said, adding that Mr. Clinton's approach may be a "second-best" way to accomplish that goal.

The heart of the complex debate is what Washington should—and can—do with budget surpluses that the White House estimates will total \$4.4 trillion in the next 15 years.

Many economists, most notably Mr. Greenspan, feel the money should be used to pay down debt, which they say will lower interest rates, raise national savings and investment, and boost long-term growth rates. Mr. Greenspan called Mr. Clinton's plan for the surplus "a major step in the right direction."

Republicans don't necessarily disagree. But they contend it is unrealistic to expect Washington to sit on surpluses for many years without boosting spending or cutting taxes. "If I look out there and look at Congress, they are going to spend it," Sen. Domenici said. So, he and other Republicans prefer a big tax cut. On that point, they won Mr. Greenspan's qualified endorsement: He repeated his oft-stated view that if the government can't protect surpluses, it is better to cut taxes than increase spending.

Republicans are increasingly vocal in opposing the complex way that Mr. Clinton does pay down the debt. The Clinton plan would use about \$2.8 trillion to pay down debt. For every dollar of debt paid down, Mr. Clinton would give an extra dollar of IOUs to the Social Security trust fund to pay for benefits from 2032 to 2055. Under that scenario, those benefits would essentially be paid out of general revenues.

Despite his praise for parts of Mr. Clinton's Social Security plan, Mr. Greenspan agreed with critics that it doesn't do much to solve the long-term cost problems. Mr. Clinton's proposals avoid any painful changes, and Mr. Greenspan said that ultimately, "in all likelihood . . . taxes will have to be raised, or benefits cut." Mr. Greenspan also cautioned against assuming that the White House's rosy estimates for surpluses will actually materialize.

In his testimony, Mr. Greenspan also reiterated his opposition to another portion of the Clinton Social Security plan that drew the most attention when the package was first unveiled last week: investing some of the trust fund in the stock market. "Even with Herculean efforts, I doubt it would be feasible to insulate, over the long run, the trust funds from political pressures," the Fed chairman said.

THE WALL STREET JOURNAL

FRIDAY, JANUARY 29, 1999





February 22, 1999

## Washington Diarist: Doubletalk

By Jonathan Chait

The most irritating thing about newspapers is their convention of presenting disagreements on matters of fact as nothing more than differences of opinion. Recently, a city official here resigned because he used the word "niggardly." A Washington Post story reported that the word "means different things to different people." Most of the Washingtonians quoted felt it could be taken as a slur, but others did not. And who is the Post to say which side is right? The same day, another Post story reported that President Clinton's Social Security plan is in trouble; it is widely thought to be a "budgetary sleight-of-hand that actually has the effect of counting twice the money that would have gone into the program anyway." Now, it is either double-counting or it isn't, but the article did not delve into the merits of the accusation. Instead it focused on the fact that "serious questions are surfacing."

The question surfaced, among other places, in an article in last week's *tnr* by Matthew Miller. For those who missed it, Miller assumes the following scenario: The budget surplus is \$150 billion, of which \$100 billion comes from the leftover Social Security taxes that weren't used to pay for current benefits. That \$100 billion goes into the Social Security trust fund. Then Clinton takes 60 percent of the total budget surplus--\$90 billion--and gives it to the trust fund. That means the trust fund gets a total of \$190 billion. Since this is more than the total value of the budget surplus, Miller concludes that Clinton's plan "double-counts" and is also a "scam," "legerdemain," and a good dozen other synonyms.

I admit it looks strange. But there's a perfectly decent explanation. Suppose that I loan you a dollar, and you promise to pay me back with interest. The Chait trust fund is now worth one dollar. Then, out of the goodness of your heart, you decide to give me back the same dollar as a gift. Now I am worth two dollars: the dollar I have, plus the dollar you still owe me. Clinton's proposal works the same way. Social Security brings in an extra dollar that it doesn't need this year. It loans the dollar to the rest of the federal budget, and in return the federal government deposits an IOU for one dollar in Social Security's trust fund. (The trust fund is an accounting device to keep track of all the dollars Social Security has loaned out.) Now the extra dollar belongs to the non-Social Security budget, and the government can spend it any way it wants. Clinton proposes giving that dollar-- 60 cents of that dollar, actually, but let's keep it simple--back to the Social Security trust fund. Then the trust fund takes the dollar and purchases a \$1 federal bond from the general public. Hence, it has increased its value by more than the value of the budget surplus.

In case it sounds like I'm trying to pull a fast one, let's ponder those two transactions in turn. The first part simply involves lending the Social Security surplus to the general budget. This resembles double-counting in the sense that the money credited to the trust fund can also be used for other purposes. Yet, while the outcry in the press might make you think that Clinton invented this tactic, every federal budget has done this for decades. Indeed, the very same Republicans who are denouncing Clinton--including self-proclaimed budget hawks such as John Kasich and Pete Domenici--have themselves proposed using the budget surplus, made up largely of Social Security funds, to pay for new tax cuts or private retirement accounts.

The only new element is what Clinton proposes to do with the money after Social Security lends it to the general budget. The general budget gives most of the money right back to the

trust fund as a grant, not a loan. The trust fund takes about 15 percent of the money and gives it to an independent board to invest in stock indexes. (This part is also controversial, but I won't get into it right now.) It invests the rest of the money in Treasury bills, thus reducing the national debt. Again, this might appear suspicious--how can you use the same dollar to reduce the national debt and bolster the Social Security trust fund? The answer is that it has the same economic effect as reducing the national debt. Right now there are millions of Americans who own federal bonds--IOUs for money they've lent to Uncle Sam. When the trust fund buys up some of those bonds, the public then can use the money to spend or invest in the private sector. To the extent the money is invested in efficient new productive capacity, it strengthens the economy over the long run. Also, by reducing the debt it owes to the public, the government increases its ability to borrow in the future. The only twist is that Clinton's plan guarantees that the benefits of this saving accrue to Social Security. If this still strikes you funny, consider an alternative scenario. If Clinton took the Social Security portion of the budget surplus and spent it all on tax credits or child care or wild parties in the Oval Office, the money would still be credited to the trust fund. So, if he instead saves the money for Social Security, shouldn't the trust fund reflect the difference?

One common objection is that bolstering the trust fund cannot work because it accumulates nothing but IOUs. But the debtor on those IOUs is the United States government, the safest credit risk in the history of civilization. And the creditors are future Social Security recipients, who demonstrate roughly the same level of forgiveness toward missed payments as a loan shark from the Gambino family. Anyway, this isn't a reason to oppose Clinton's plan, which boosts the government's capacity to make good on future debts.

But Miller doesn't claim the trust fund won't be there. Instead he argues that Clinton is simply pulling money out of the sky. The "logical extension" of the Clinton plan, he writes, is "to use the same accounting trick to boost the trust fund a few extra trillion and announce that Clinton had put the Social Security problem behind us altogether." He's arguing, in other words, that Clinton's plan would have allowed him to add as much money as he wanted to the trust fund. But this is simply not the case. The most Clinton could have put into the trust fund is twice the surplus. This is a fact, not an opinion.

The president's idea might not be in so much trouble, then, if Congress and the media actually understood it. But, then again, maybe it wouldn't matter. Upon hearing that "niggardly" derives from Middle English and Scandinavian dialects, one offender shrugged: "Do we really know where the Norwegians got the word?" Yes, maybe they anticipated that, centuries hence, the word "nigger" would become a slur in English and then subsequently become socially unacceptable, so they preemptively sneaked a similar-sounding word into the language. All I know for sure is that serious questions are surfacing.

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To: Jonathan Kaplan, Brian Barreto  
Cc: Mary Beth Cahill  
From: Jonathan Young  
Date: March 8, 1999  
RE: Social Security Questions

Disability community representatives have been very pleased to be part of the White House Social Security Conference and have an opportunity to meet with Gene Sperling. Gene suggested that community leaders put detailed questions in writing for NEC review, as a backdrop for a follow-up meeting with Gene and other Administration staff. Below please find a summary of community concerns and questions. At your earliest convenience, I would like to schedule a follow-up meeting for the end of next week. My extension is 6-7032.

**Maintain and Strengthen Original Program Insurance Principle:** While the debate about Social Security has focused primarily on the issues of retirement and an aging America, disability representatives emphasize that Social Security was created as an *insurance* program. In the context of the Great Depression, Social Security was designed to spread the risk associated with income loss--to move away from privatized risk. Over time, the Social Security system was expanded to *insure* a variety of groups facing income losses: disabled workers, adults with disabilities who are dependent on disabled workers and retirees, adults with disabilities who are survivors of deceased workers or retirees, and disabled widow(er)s--as well as general retirees. Currently, *more than one-third* of all Social Security payments are paid to *non-retirees*. Therefore, people with disabilities urge the Administration to recognize this diversity in its communications about Social Security. The disability community can actually offer help to the Administration in arguing against privatization schemes by underscoring the insurance concept and types of beneficiaries.

**Save Surplus; Vigorously Oppose Privatization Proposals.** Disability community representatives urge the Administration to avoid diverting any Social Security surpluses from the Trust Fund (add-on private accounts, such as the USA accounts, are acceptable from this vantage point). The problem with privatization is that it reverses the intent of Social Security and opts for pre-depression levels of individual risk. While individual accounts may be effective for adults with decades of high-wage employment, they cannot sustain the third of non-retirement beneficiaries.

**Private Accounts Presume High Contribution Rates.** Disabled workers will likely make smaller contributions due to lower earnings levels. Moreover, the current insurance system enables families to benefit from a number of sources (e.g. spouses and children), not merely one individual retirement account.

**Raising the Retirement Age Could Place Unbearable Pressure on Disability Programs.** If the retirement age is increased, many people will likely apply for disability benefits, possibly creating political pressure to make drastic changes to disability insurance based on the program's expansion.

**Where Does the Administration Stand on Social Security Disability Reform?**

Disability representatives generally understand and support the need to focus first on the revenue side of the ledger, but also have considerable interests in the expenditures side. The principal issue is that the Social Security disability system is based on a definition of disability as "inability to perform substantial gainful activity." The ADA, on the other hand, defines disability as "substantial limitation of major life activities," and focuses on providing reasonable accommodations to enable people with disabilities to work. The Work Incentives Improvement Act, now under consideration in Congress, will help address some of the Social Security disincentives, but more work remains. Because public emphasis on the need for reform now could fuel privatization arguments, the disability community supports the focus on revenue. But the community urges the Administration to be thinking internally about future reform opportunities.

**Has the Administration Considered the Problems SSDI Beneficiaries Face in Calculating Retirement Benefits?** Because retirement is calculated on average earnings, individuals who exit the workforce early, for example at the age of 50, likely do not achieve their income potential, which gets reinforced in a lower retirement benefit. Has the Administration considered retirement adjustments for these individuals?

**What Proportion of the Surplus Would be Dedicated to the Disability Trust Fund?** Will the 62% of surpluses be devoted entirely to the retirement fund or shared with the Disability Insurance Trust Fund?

**How Will USA Accounts Benefit SSDI and SSI Beneficiaries?** Will USA Accounts address the needs of individuals who meet the statutory definition of disability under the Social Security Act? These individuals will generally have less opportunity to invest in a personal account due to lower earnings. Would, for example, there be a mechanism to have guaranteed continuation of contributions in the event of work loss?

**Could Individuals Draw on USA Accounts without Penalties for Disability-Related Expenses?** The expenses associated with disability may be a disincentive for setting aside money in retirement accounts. Mechanisms to draw money for disability-related expenses could avert this disincentive

**Will Assets from Equity Investments be Available to the Disability Retirement Fund?** The disability community is generally concerned that the various benefits achieved

from Social Security solvency proposals benefit the DI Trust Fund, and not only the retirement fund.

**How is the 62% of the Unified Surplus Computed Annually?** The Administration has explained that in early years most of the surplus comes from the Trust Fund, and in later years increasingly from the General Fund. Is this broken down on a year-by-year basis? Are there models for surpluses exceeding or falling short of current estimates? Disability community leaders want to ensure that nothing is done to threaten the integrity of the Trust Fund.

**Can the Administration Help Support a Requirement for Beneficiary Impact Statements?** The disability community joins Rev. Jesse Jackson in asking CBO to require that all Social Security proposals include a Beneficiary Impact Statement, similar to CBO's typical cost estimates. These statements would assess the impact that proposals for privatization, increased retirement age, benefit plan changes, etc. would have on various populations, including people with disabilities. Disability representatives also invite the Administration to prepare its own Beneficiary Impact Statement for its proposals.

**Has the Administration Considered Adjustments to the Earnings Test for SSDI Beneficiaries?** The Administration has indicated an interest in evaluating the earnings test for retirees. The retirement and disability earnings test are different in form and function (statutory definition of disability is about an inability to work, which is not the case for the definition of retirement). Nevertheless, disability experts wonder whether the Administration has considered SSDI earnings tests.

**Can the Administration Provide a Written Explanation of the Mechanism and Benefits of Reducing Public Debt (While Increasing Internal Debt)?** The Administration's talking points on debt reduction talk about the benefits of debt reduction, but do not adequately *explain* how this process functions. Opponents accuse the Administration of simply shifting and hiding debt; proponents highlight the benign nature of internal debt relative to more detrimental publicly held debt. An Administration discussion of the impact of various types of debt would be extremely helpful to community advocates.

December 15, 1998

**SOCIAL SECURITY PLANS THAT REDUCE SOCIAL SECURITY RETIREMENT  
BENEFITS SUBSTANTIALLY ARE LIKELY TO CUT  
DISABILITY AND SURVIVORS BENEFITS AS WELL**

by Kathy Larin and Robert Greenstein

The Social Security debate now underway has focused primarily on retirement benefits. Much less attention has been paid to how various changes being proposed in the Social Security benefit structure would affect disability and survivors benefits. To assess any Social Security reform plan fully, however, the impact on disability and survivors benefits should be carefully scrutinized.

This issue is particularly important because Social Security reform proposals that entail large reductions in Social Security retirement benefits generally contain substantial reductions in disability and/or survivors benefits as well. This is a result of the Social Security benefit structure, which uses a common benefit structure to determine monthly benefit levels for retirement, survivors and disability benefits alike.

Various proposals now emerging would shift a portion of Social Security payroll tax revenues from the Social Security trust funds to private individual accounts. Under a number of these proposals, beneficiaries would be guaranteed a "defined benefit" from the Social Security trust fund, as under current law, and receive supplemental income from their individual accounts. Such proposals generally entail quite large reductions in Social Security benefits — those benefits must be cut enough to close the current long-term shortfall in Social Security's finances and then reduced further to make up for the loss of the revenues being diverted from the trust funds to individual accounts. For example, diverting two percentage points of the payroll tax to private accounts, as some proposals do, would nearly double the size of the long-term Social Security shortfall and thus substantially deepen the Social Security benefit reductions required to restore long-term solvency to the system. As a result, proposals that shift revenue from the Social Security trust funds to private accounts generally entail large reductions not only in Social Security retirement benefits, but also in Social Security disability and survivors benefits.

Substantial reductions in disability and survivors benefits pose a particular problem. Although the income from individual accounts may make up for the loss of a substantial portion or all of lost Social Security *retirement* benefits for some individuals, depending on how the stock market performs, the individual's investment decisions, and other factors, income from individual accounts can *not* make up for much of the loss of Social Security disability benefits by workers who become disabled well before retirement age or for the loss of survivors benefits by the spouses and dependents of

workers who die well before retirement age. The individual accounts of such workers will not have accumulated sufficient assets to make up for the reduction in disability and survivors benefits.

Aggravating this problem and sharpening the impact of the loss of Social Security disability and survivors benefits is the fact that such benefits often involve multiple benefit payments — they entail payments to dependents as well as to the disabled worker or the surviving spouse of a deceased worker. That a death or disabling accident can trigger Social Security benefit payments to *a number* of individuals rather than just to *one* beneficiary makes it even more difficult for the income from a single individual account to compensate for reductions in disability and survivors benefits.

### **Legislation Based on the NCRP Plan As An Example**

To illustrate this problem, we examine legislation introduced by Senators Judd Gregg and John Breaux and Reps. Jim Kolbe and Charles Stenholm (S. 2313 and H.R. 4824). This legislation is based on a Social Security proposal unveiled this spring by the National Commission on Retirement Policy, a panel of Members of Congress and private citizens.<sup>1</sup> Other plans entailing reductions in Social Security retirement benefits also would affect disability and survivors benefits to various degrees, as the box on page 15 explains.

In issuing its plan, the National Commission on Retirement Policy expressed its intention to protect disability benefits from cuts. Subsequent statements by proponents of this legislation also reflect that intent. For example, at the town hall meeting held to discuss Social Security reform in Albuquerque on July 27, 1998, Rep. Kolbe stated, "...our proposal does not touch the disability or the survivors....we keep [disability] intact; it's exactly as it will be."<sup>2</sup>

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<sup>1</sup> This House bill was originally introduced as H.R. 4256 and then re-introduced as H.R. 4824 to reflect technical corrections and correct some drafting errors in the first bill. S. 2313 was introduced at the same time as H.R. 4256 and does not include these corrections. This analysis assumes the same changes will be made to the Senate bill. The bill numbers for both the House and Senate bills will change when the bills are reintroduced during the next session of Congress.

<sup>2</sup> Social Security has two trust funds, the Old Age and Survivors Insurance trust fund, which funds retirement and survivor benefits, and the Disability Insurance trust fund, which funds disability benefits. Both trust funds are projected to become insolvent in coming decades. Because the two trust funds are essentially fungible, Social Security solvency can be restored by making changes that make the overall system solvent and adjusting accordingly the share of Social Security revenues placed in each trust fund. To restore solvency, it is not necessary to reduce disability benefits by some particular amount or percentage. To the degree that disability benefits are shielded, somewhat larger changes likely would be needed in retirement benefits.

But in drafting the legislation based on this plan, the sponsors of S. 2313 and H.R. 4824 found that despite their strong desire not to cut disability benefits, it was not feasible to institute the large reductions in Social Security retirement benefits their plan entailed without making substantial reductions in disability and survivors benefits as well.<sup>3</sup> The only way the NCRP legislation could have made its reductions in Social Security retirement benefits without substantially reducing disability benefits at the same time would have been through measures that would introduce severe inequities and perverse incentives into the Social Security benefit structure.

The NCRP does contain a mitigating provision — it establishes a minimum benefit that would largely or fully shield from these benefit reductions those disabled workers who earned well-below-average wages during their work-years and were employed for most or all of their adult lives before becoming disabled. This provision also would shield survivors of deceased workers who earned very low wages and were employed most of their adult lives, as well as retirees who earned very low wages during their work years. Due to this provision, some retirees, disabled individuals, and survivors of deceased individuals who earned very low wages before retiring, becoming disabled, or dying actually would receive larger Social Security benefits than under current law.

For disabled workers and survivors who would *not* be affected by the minimum benefit provision, however — a group constituting the majority of beneficiaries of disability and survivor benefits — the benefit cuts would be large. For example, when the legislation took full effect, the Social Security disability benefits provided to an individual who had earned average wages before becoming disabled would be reduced nearly 20 percent, as compared to current law.

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<sup>3</sup> In theory, the legislation based on the NCRP plan could have left disability and survivors benefits largely untouched. This could have been accomplished by replacing the plan's changes in the Social Security basic benefit formula and in the annual Social Security cost-of-living adjustment with much steeper increases in the age at which workers can retire and receive full Social Security benefits. Raising the age at which beneficiaries can retire and receive full benefits does not affect disability benefit levels or benefits for survivors of workers who die before reaching retirement.

In practice, however, such a change would hold little attraction. The NCRP plan already contains a larger increase in the age at which beneficiaries can retire and receive full benefits than any other major Social Security plan put forward. Of the three rival Social Security plans advanced by members of the 1994-1996 Social Security Advisory Council, the plan that went farthest in raising the age at which individuals can retire and receive full benefits would increase this age from 65 today (and, under current law, 67 starting in 2022) to age 70 by 2083. By contrast, the NCRP plan would raise the age to 70 by 2029 and to approximately 72½ by 2075. The NCRP also would raise the age at which *early* retirees can begin to receive reduced Social Security benefits from 62 to 65 by 2029 and to approximately 67½ by 2075. Replacing those provisions of the NCRP plan that would result in substantial reductions in disability and survivors benefits with provisions requiring still greater increases in the retirement age would entail raising the age at which workers may retire and receive full benefits to levels significantly higher than those the NCRP plan already proposes.

The legislation includes a provision calling for an expert panel to study and make recommendations concerning possible future changes that could ease the reductions in disability benefits the legislation contains. This panel, however, would face the same dilemmas that led the sponsors of S. 2313 and H.R. 4824 reluctantly to include substantial disability benefit reductions in their bills, since there is no easy solution that eluded the legislation's framers. Moreover, the legislation specifies that any recommendations the panel might make to ease the legislation's disability benefit cuts after the legislation had been enacted would have to be accompanied by recommendations for offsetting reductions elsewhere in the Social Security Disability Insurance program so that disability insurance costs did not rise above the levels to which the legislation had reduced them.

### **Background on Disability and Survivors Benefits**

The Social Security system provides benefits not only to retirees but also to the survivors of workers who die before reaching age 62 and to workers who become disabled before 62 and their dependents.

- Workers who become disabled before they reach retirement, as well as members of these workers' families, are eligible for benefits under the disability insurance program that is part of Social Security.<sup>4</sup>
- Survivors benefits are available to the children of workers who have died before reaching retirement and the spouses of such deceased workers if the spouses are caring for dependent children, are over 60, or are disabled themselves. Survivors benefits also go to spouses and minor children of workers who die after retiring.

In December 1996, disabled workers and their families comprised more than six million people, or nearly 14 percent of all Social Security beneficiaries. An additional 7.4 million beneficiaries, nearly 17 percent of all Social Security beneficiaries, were survivors and their families. Together, these two components of Social Security account for nearly one-third of Social Security beneficiaries — 13 million to 14 million people.

### **How Disability and Survivors Benefits are Determined**

The level of disability or survivors benefits that beneficiaries receive is determined under the same benefit formula as is used to calculate Social Security

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<sup>4</sup> To receive Social Security disability benefits, disabled workers must have worked one quarter for each year between the year they turned 21 and the year they become disabled, with a minimum of six quarters of work. They also must have worked 20 of the 40 quarters before becoming disabled if they become disabled after age 31 and half of the quarters between the time they turn 21 and the time they become disabled if they become disabled before turning 31.

retirement benefits. The benefit formula starts with the calculation of a covered worker's "average indexed monthly earnings"; these are the worker's average wages over his or her work career. Wages for each year from the past are indexed by national wage growth to account for wage inflation between the year the worker earned those wages and the year that falls two years before the time the worker becomes eligible for benefits.

For *retirees*, the highest 35 years of wages are indexed in this manner, averaged and divided by 12 to obtain the worker's "average indexed monthly earnings" (known as the worker's AIME). For the *disabled* and *survivors*, a worker's average indexed monthly earnings are calculated using wages for the years between the time the worker turned 21 and the time the worker became disabled or died. For most Social Security beneficiaries, up to five of the years in which the worker had the lowest earnings are disregarded in these calculations.<sup>5</sup>

The worker's average indexed monthly earnings are then used to determine what is known as the worker's "primary insurance amount" or PIA. A worker's monthly Social Security benefit is based on his or her PIA. Specifically, for workers who retire at age 65, for disabled beneficiaries, and for the survivors of workers who die before reaching retirement, the monthly Social Security benefit they receive when they begin drawing benefits *equals* their PIA, rounded down to the next lowest dollar.

The calculation of the primary insurance amount, which determines the monthly benefit, is done in the same fashion *regardless of whether the beneficiary is a retiree, disabled, or a survivor*.<sup>6</sup>

- For a retiree, a disabled worker, or a survivor of a deceased worker who becomes eligible for Social Security benefits in 1998, the PIA — and hence

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<sup>5</sup> For survivors, the lowest five years of wages (known as "drop-out years") are disregarded in the calculation of the AIME unless the worker died before working seven full years, in which case all but the two highest wage years are disregarded in the calculation. For the disabled, depending on the age of the worker at the time of disability and the number of years worked, up to five years in which the worker earned the lowest wages are disregarded in the computation of the AIME. (As an example, if a worker who worked since age 21 becomes disabled at 31, the highest eight years of wages are indexed and averaged to determine the worker's AIME, while the two years with the lowest wages are disregarded.) By omitting from the AIME calculation the years in which the worker earned the least, the Social Security benefit structure ensures that workers who were either unemployed for brief periods or left the labor force for a few years to provide child care, attend college, or for other reasons are not penalized.

<sup>6</sup> A disabled worker's benefit is equal to 100 percent of the worker's PIA rounded down to the next dollar. Each dependent of the disabled worker is eligible to receive an additional benefit equal to 50 percent of the worker's PIA. Widows and widowers of deceased workers and minor or disabled children of deceased workers are eligible for a survivor's benefit based on a portion of the deceased worker's PIA. The combined benefits of all beneficiaries in a family (except divorced spouses) cannot exceed a maximum level, or cap.

**Table 1**  
**Determination of a Worker's Monthly Benefit Under Current Law,**  
**for a Worker Becoming Eligible for Benefits in 1998<sup>7</sup>**

| <b>Formula using worker's<br/>Average Indexed Monthly<br/>Earnings (AIME)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>Worker with<br/>AIME of \$972<br/>(Low earner)</b> | <b>Worker with AIME<br/>of \$2,162<br/>(Average earner)</b> | <b>Worker with AIME<br/>of \$5,225<br/>(Maximum earner)</b> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|-------------------------------------------------------------|-------------------------------------------------------------|
| 90% of first \$477                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | \$429.30                                              | \$429.30                                                    | \$429.30                                                    |
| 32% of AIME between \$477<br>and \$2,875                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | \$158.40                                              | \$539.20                                                    | \$767.36                                                    |
| 15% of AIME over \$2875                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                       |                                                             | \$352.50                                                    |
| Primary Insurance Amount<br>(PIA)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | \$587.70                                              | \$968.50                                                    | \$1,549.16                                                  |
| Benefit Level <sup>8</sup>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | \$587.00                                              | \$968.00                                                    | \$1,549.00                                                  |
| <p><sup>7</sup> Table 1 shows monthly benefit calculations for workers with low earnings, workers with average earnings, and workers with "maximum" earnings. The low earner— the worker with an AIME of \$972 — has an AIME equal to 45 percent of the average earnings level. The "maximum" earner— the earner with an AIME of \$5,225 — has an AIME equal to the maximum earnings subject to the Social Security payroll tax. The earnings levels shown here for low earners and maximum earners are the levels the Social Security Administration uses for illustrative purposes.</p> <p><sup>8</sup> The benefit level equals the primary insurance amount rounded down to the next dollar.</p> |                                                       |                                                             |                                                             |

the monthly Social Security benefit after rounding to the next lowest dollar — equals 90 percent of the worker's average indexed monthly earnings after rounding to the next lowest dollar *if* the worker's AIME does not exceed \$477 a month.

- If the worker's AIME falls between \$477 and \$2,875 a month, the PIA (and, after rounding down, the monthly Social Security benefit) equals 90 percent of the first \$477 of the worker's average indexed monthly earnings, plus 32 percent of the worker's average indexed monthly earnings above \$477.
- For workers with AIMEs exceeding \$2,875, the PIA (and the monthly Social Security benefit after rounding) equals 90 percent of the first \$477 in average indexed monthly earnings, plus 32 percent of the next \$2,398 of those earnings (the amount between \$477 and \$2,875), plus 15 percent of the worker's AIME in excess of \$2,875.

Table 1 shows the monthly benefit calculations for three workers with different levels of average indexed monthly earnings. The "low earner" is an earner with an

AIME equal to 45 percent of the average earnings level. A "low earner" retiring in 1998 would have average annual pre-retirement earnings of about \$12,250. An average earner retiring this year would have average annual pre-retirement earnings of just under \$26,000. A maximum earner is one whose average pre-retirement earnings equal the maximum amount of earnings subject to the Social Security payroll tax. Earnings above this level are neither subject to the payroll tax nor used to calculate an individual's Social Security benefit level.

### **Provisions of the NCRP Legislation that Affect Disability and Survivors Benefits**

Most of the remainder of this paper uses the legislation based on the NCRP proposal, the legislation Senators Gregg and Breaux and Reps. Kolbe and Stenholm have introduced, to illustrate how changes in disability and survivors benefits can be intertwined with changes in Social Security retirement benefits. The major provisions of this legislation that relate to Social Security benefit levels are listed in Table 2. Some of these provisions affect only the retirement portion of Social Security, but others impact disability and survivors benefits as well.

**Table 2**  
**Major Social Security Benefit Provisions of H.R. 4824 and S. 2313**

| <b>Provisions</b>                                                                    | <b>Effect on Disability and Survivors Benefits</b>                                                                                             |
|--------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|
| Change the formula for calculating the primary insurance amount                      | Reduces benefits for most beneficiaries, with a reduction of 18.5 percent for a worker earning average wages before becoming disabled or dying |
| Minimum benefit provision                                                            | Protects the benefits of survivors and disabled workers with low earnings and strong labor force attachment                                    |
| Modify cost-of-living adjustments so they rise more slowly than the current CPI does | Affects benefits of all beneficiaries, including the disabled and survivors                                                                    |
| Reduce the number of "drop-out years" and lengthen the wage averaging period         | Reduces survivors benefits                                                                                                                     |
| Raise the retirement age                                                             | Primarily affects retirement benefits and the benefits of survivors of retired workers                                                         |
| Include state and local employees                                                    | No effect                                                                                                                                      |

**Table 3**  
**Benefit Calculations Under NCRP**  
**Legislation and Current Law**

| <b>Under current law, the monthly benefit equals:</b>        | <b>Under H.R. 4824 and S. 2313, when fully phased in, the monthly benefit equals:</b> |
|--------------------------------------------------------------|---------------------------------------------------------------------------------------|
| 90% of first \$477 in average indexed monthly earnings, plus | Same                                                                                  |
| 32% of AIME between \$477 and \$2,875, plus                  | 21.36% of AIME in this bracket, plus                                                  |
| 15% of AIME above \$2,875                                    | 10.01% of AIME in this bracket                                                        |

### Change in Benefit Determination Formula

One of the major provisions of this legislation would alter the way in which retirement, disability, and survivors benefits are calculated. The legislation calls for changing the computation of a worker's monthly benefit by reducing, by the year 2023, the 32 percent bracket in the formula for computing a worker's primary insurance amount to 21.36 percent, and reducing the 15 percent bracket to 10.01 percent. Thus, an individual's monthly benefit would be calculated by taking 90 percent of the first \$477 of the worker's AIME (in 1998 dollars), the same percentage as under current law, but 21.36 percent of the worker's AIME between \$477 and \$2,875 instead of 32 percent of this amount, and 10.01 percent of the worker's AIME over \$2,875 instead of 15 percent of that amount. The proposed change is shown in Table 3.

For very low-wage earners — those with average indexed monthly earnings of \$477 or less — these changes would have no impact. In fact, very low-wage workers who work most or all years between turning 21 and becoming eligible for benefits would likely receive an increased benefit as a result of the legislation's minimum benefit provision, discussed below in more detail. But for beneficiaries with modestly below-average, average or above-average earnings, as well as for most beneficiaries who earned very low wages but were not employed each year between the time they turned 21 and the time they became eligible for benefits, this change would reduce the monthly Social Security benefit. Because this change in the benefit formula would affect the computation of disability and survivors benefits as well as retirement benefits, it would reduce disability and survivors benefits along with retirement benefits.

For many workers, the impact of this change on disability and survivors benefits would be substantial. An analysis by the Social Security Administration's Chief Actuary shows that this change in the monthly benefit formula would reduce benefits to a disabled Social Security beneficiary who earned average wages, which equal

**Table 4**  
**Determination of the Monthly Benefit for an Average-wage Worker Who Becomes Disabled Under H.R. 4824 and S. 2313, When Fully Implemented**

| <b>Formula Using Worker's Average Indexed Monthly Earnings (AIME)</b> | <b>Average-Wage Worker</b> |
|-----------------------------------------------------------------------|----------------------------|
| 90% of first \$477                                                    | \$429.30                   |
| 21.36% of AIME between \$477 and \$2,875 (worker's AIME is \$2,162)   | \$359.92                   |
| 10.01% of AIME over \$2,875                                           | \$0                        |
| Monthly benefit under H.R. 4824 and S. 2313                           | \$789.00                   |
| Monthly benefit under current law (see Appendix Table 1)              | \$968.00                   |
| Reduction in monthly benefit                                          | -\$179.00                  |
| Percentage benefit reduction                                          | -18.5 %                    |

\$27,894 in 1998, by 18.5 percent when the formula change was phased in fully.<sup>9</sup> (See Table 4.)

Survivors also would face reduced benefits. Under current law, for example, a 60-year-old surviving widow of an average-wage worker is eligible for a monthly benefit of \$692. If H.R. 4824 and S. 2313 were law and fully in effect, such a widow would receive a monthly benefit of \$564. This, too, is a reduction of 18.5 percent.

The percentage reduction in benefits would be smaller than 18.5 percent for workers with below-average wages. (And as noted, some very-low wage workers would be shielded entirely from this benefit reduction or receive a benefit increase due to the legislation's minimum benefit provision.) The benefit reduction would be greater than 18.5 percent for those who had earned above-average wages.

Because the primary insurance amount is calculated in the same manner for all Social Security beneficiaries, these percentage reductions in benefits would be the same regardless of whether the beneficiary is a retiree, a disabled worker or a survivor. The dependents of disabled workers and the families of survivors also would be affected, since their Social Security benefits equal a specified percentage of the worker's PIA. A reduction of a given percentage in a worker's PIA would cause the benefits for these dependents to be cut by the same percentage.

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<sup>9</sup> Social Security Administration, "Impact on Low Earners of Proposals to Address Long-Range Social Security Solvency" unpublished report, 1998.

Proponents of partial privatization plans often argue that reducing the basic guaranteed benefit payable to retirees through the Social Security retirement system will not necessarily reduce retirees' total incomes, because the retirees also will secure retirement income from the savings in their individual accounts. Income from these accounts could offset reductions in Social Security benefits; some beneficiaries would likely come out ahead and others behind, depending on how their investments performed, the costs and fees charged on the accounts, and a number of other factors.<sup>9</sup>

For the disabled and survivors of workers who die before retirement, however, individual accounts generally would fail to bridge the gap between current benefit levels and the benefits available under partial privatization legislation such as

#### **Adults Who Have Been Disabled Since Childhood Would be Affected Most Adversely**

One group for whom private accounts are least likely to compensate for the difference between current Social Security benefit levels and the reduced Social Security benefits available under partial privatization plans such as H.R. 4824 and S. 2313 consists of adults who have been disabled since childhood and who become eligible for Social Security when their parents retire, die, or themselves become disabled. "Disabled adult children," as these individuals are known, are eligible for a Social Security benefit equal to a specified percentage of their parent's primary insurance amount.

Both their parents and these disabled adult children would receive lower Social Security benefits under proposals such as H.R. 4824 and S. 2313 than under current law, because of the changes these bills make in determining a beneficiary's primary insurance amount. The parents of these disabled adult children also would accumulate private accounts to supplement their reduced Social Security retirement benefits. (The disabled adult children themselves will have little or no earnings and thus no significant private accounts of their own.) But while the amounts in the parents' private accounts might be sufficient to make up for a substantial portion or all of the reductions in the parents' Social Security benefits, it is unlikely these accounts would make up for the reduction in the benefits of the disabled adult children as well.

As a result, hardship could ensue. Consider, for example, what would occur after the parents of disabled adult children died. By the time of their deaths, many such parents would have largely or entirely depleted their private accounts. That would leave little or no savings to supplement the reduced Social Security benefits upon which their disabled adult children would have to depend for the rest of their lives.

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<sup>9</sup> See Kilolo Kijakazi and Robert Greenstein, "How Would Various Social Security Reform Plans Affect Social Security Benefits: An Analysis of the Congressional Research Service Report," Center on Budget and Policy Priorities, September 9, 1998; Peter Diamond, "The Future of Social Security for this Generation and the Next: Proposals Regarding Personal Accounts," Testimony before the Subcommittee on Social Security of the House Committee on Ways and Means, June 18, 1998; and testimony of Henry Aaron before the Senate Committee on the Budget, July 23, 1998.

H.R. 4824 and S. 2313. Workers who become disabled or die at a young age will not have accumulated much in their individual accounts, as they will not have contributed to these accounts for that many years. For many of these individuals and their families, the change that H.R. 4824 and S. 2313 would make in the calculation of the monthly benefit would result in a significant reduction in monthly income compared to what they would receive under current law.<sup>10</sup>

### Change in Cost-of-Living Adjustments

These estimates of the percentage amounts by which disability and survivors benefits would fall due to the changes H.R. 4824 and S. 2313 would make in computing the primary insurance amounts do not reflect the full extent of the reductions in disability and survivors benefits that would occur under these bills. Additional benefit reductions would result from other changes the bills would make in determining benefit levels, such as changes in the Social Security cost-of-living adjustment.

Under current law, Social Security benefits rise each year by the percentage increase in the Consumer Price Index. H.R. 4824 and S. 2313 would change this; they would adjust Social Security benefits not by the CPI but by a new "Social Security Consumer Price Index" that the legislation would create. The Social Security CPI would equal the regular CPI *minus* an estimate of the amount of "substitution bias" remaining in the regular CPI.

Substitution bias can occur when consumers substitute lower-cost items for higher-cost items as prices change. For example, if the price of beef increases more than the price of chicken, consumers will tend to purchase less beef and more chicken. Because the CPI measures the change in prices of a fixed "market basket" of goods and services, it assumes the quantities of beef and chicken a typical consumer buys do not change each year. The CPI is adjusted once every 10 years for such changes in purchasing patterns, but this process does not capture changes in purchasing patterns on a year-to-year basis within the 10-year intervals. As a result, the index may overstate inflation to some degree.

H.R. 4824 and S. 2313 would require the Bureau of Labor Statistics, the agency that calculates the CPI, to publish annually the amount by which the CPI has been reduced to correct for substitution bias. BLS also would be required to publish an estimate of the amount of substitution bias remaining in the CPI. Under the legislation, the Social Security CPI would equal the CPI (including whatever corrections the BLS has made in it) minus any substitution bias BLS estimates to remain.

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<sup>10</sup> Workers who become disabled only shortly before reaching retirement age would have accumulated more in their individual accounts and thus would receive more income from these accounts.

The legislation also contains a related requirement — that in calculating the Social Security CPI, the CPI must be reduced *no less than 0.5 percentage points* to compensate for substitution bias, regardless of BLS' estimate of how much substitution bias remains. In April 1998, BLS announced improvements in the CPI that will reduce substitution bias in the index by 0.2 percentage points when the improvements are incorporated in the index in 1999. BLS plans to make additional changes in 2002 that are expected to reduce substitution bias an additional 0.15 percentage points, for a total reduction of 0.35 percentage points.<sup>11</sup> BLS is not planning any further changes to adjust for substitution bias; it estimates the adjustments now in process will resolve the substitution bias problem. In the absence of further changes, however, the Social Security CPI that the NCRP legislation establishes would be set approximately 0.15 percentage points below the CPI, as corrected by BLS, to secure the minimum 0.5 percentage point reduction for substitution bias the legislation requires.<sup>12</sup>

Over time, the effect of such a downward adjustment each year in the cost-of-living adjustment would be to erode the value of Social Security benefits relative to current law. These benefit reductions would tend to be largest for workers who become disabled well before reaching retirement age, since these beneficiaries typically receive benefits for a greater number of years than retirees do.

The provision's impact on a disabled worker who becomes eligible for Social Security at a relatively young age can be seen with an example. Consider a worker with average indexed monthly earnings of \$2,083 (equivalent to average annual earnings of \$25,000 in 1998 dollars) who becomes disabled at age 30. Under current law, the worker's benefit is \$943 a month when he or she begins to draw it. When fully in effect, the provision of H.R. 4824 and S. 2313 that would change the formula for calculating a worker's primary insurance amount would reduce this benefit to \$772 a month, an 18 percent reduction. Now assume that inflation as measured by the CPI

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<sup>11</sup> Technically, the substitution bias correction scheduled for 2002 cannot be made in the CPI itself because the data needed to make this correction are not available in a manner that allows them to be reflected in the monthly CPI data. As a result, BLS plans to introduce a second cost-of-living index in 2002 that essentially is the CPI as modified to reflect this substitution-bias correction.

<sup>12</sup> A commission charged with evaluating the CPI and chaired by Michael Boskin concluded in 1996 that the CPI was overstated by approximately 1.1 percentage points per year, with substitution bias accounting for 0.4 percentage points of the total. BLS now estimates that substitution bias causes the index to be overstated by 0.35 percentage points. The change to the CPI scheduled for 1999 will eliminate 0.2 percentage points of this bias, and the introduction of a new cost-of-living index in 2002 will eliminate an additional 0.15 percentage points of bias.

BLS periodically reevaluates and makes changes to the CPI. It is unlikely, however, that the BLS will make corrections for substitution bias that total 0.5 percentage points any time soon. As a result, under H.R. 4824 and S. 2313, the annual Social Security cost-of-living adjustments would be smaller than the CPI, which would result in Social Security benefit reductions compared to current law.

**Table 5**  
**Potential Impact of Cost-of-Living and PIA Changes in**  
**H.R. 4824 and S. 2313 on Disability and Survivors Benefits**

| <b>Worker with AIME of \$2,083 (\$25,000 per year)<br/>who becomes disabled at age 30</b> |                    |                              |
|-------------------------------------------------------------------------------------------|--------------------|------------------------------|
|                                                                                           | <b>Current Law</b> | <b>H.R. 4824 and S. 2313</b> |
| Benefit at age 30                                                                         | \$943              | \$772                        |
| Average annual cost-of-living adjustment                                                  | 2.5 %              | 2.35%                        |
| Benefit at age 60                                                                         | \$1,978            | \$1,550                      |

averages 2.5 percent per year for the next 30 years and BLS does not introduce additional changes to the CPI to reduce substitution bias, beyond the 0.35 percentage point reductions already scheduled. Under the legislation, the worker's benefit would be raised an average of 2.35 percent per year to compensate for inflation rather than 2.5 percent, because the Social Security cost-of-living adjustment would equal the regular CPI minus 0.15 percentage points. By age 60, this would reduce the worker's benefit an additional four percent, bringing the total reduction in Social Security disability benefits paid at age 60 to 22 percent, compared to the benefit payable under current law. Instead of receiving a disability benefit of \$1,978 per month at age 60 as under current law, the disabled worker would receive \$1,550. (See Table 5.)

#### **Another Change Affecting Survivors Benefits**

H.R. 4824 and S. 2313 include another provision that would lower the Social Security benefits of many survivors, although it would not affect the disabled. Under current law, the five years of a beneficiary's lowest earnings are omitted from the calculation of the beneficiary's average indexed monthly earnings. (In Social Security parlance, these are termed "drop-out years.") Under H.R. 4824 and S. 2313, by contrast, the five lowest years of earnings would be counted rather than dropped when computing retirement and survivors benefits. No similar change would be made in computing disability benefits.<sup>11</sup>

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<sup>11</sup> Currently, when figuring retirement benefits, the amounts a worker has earned in his or her 35 highest earnings years are indexed, added, and divided by 420 (which equals 35 years times 12 months) to determine the worker's average indexed monthly earnings. Under H.R. 4824 and S. 2313, *all* of a worker's earnings years would be totaled and then divided by 480 (which equals 40 years times 12 months).

For one group of retirees and survivors of retirees, this change could *raise* average indexed monthly earnings and hence Social Security benefits. These are retired workers, and survivors of retired

(continued...)

Most workers do not have the same earnings each year of their working lives; they have low earnings when they are young and higher earnings when they are older. More than 60 percent of workers take at least one year out to raise children, attend school, or for some other reason, and have zero earnings for one or more years. The provision of current law disregarding the five lowest earning years helps these workers. Including rather than disregarding these five years, as H.R. 4824 and S. 2313 would do, would lower average indexed monthly earnings — and hence monthly Social Security benefits — for many retirees and survivors of deceased workers.

Other proposals to reform Social Security that either reduce the number of drop-out years or average the highest 38 years of earnings when computing retirement benefits, rather than the highest 35 years as under current law, also would lower workers' AIMEs and reduce their benefits. For example, the Social Security plan that Robert Ball has developed would calculate the AIME for retirees using their highest 38 years of earnings. This provision of the Ball plan would reduce benefits modestly for most retirees and most survivors of workers who died after reaching retirement age. Because the Ball plan does not reduce the number of drop-out years, however, this aspect of it should not affect the benefits of the disabled or of survivors of workers who die before reaching retirement age (with the exception of some individuals who become disabled very close to retirement age and some survivors of workers who die very close to retirement age).<sup>13</sup>

### **Minimum Benefit Provision**

Although the majority of disabled and survivor beneficiaries would receive reduced benefits under H.R. 4824 and S. 2313, not all beneficiaries would face cuts. Workers with very low earnings and strong labor force attachment would be protected by a provision in the legislation that provides a guaranteed minimum benefit. This

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<sup>11</sup> (...continued)

workers, who began working and earning significant wages before age 21 and who worked most or all of the year in nearly every year until they retired. For these workers, more than 40 years of earnings would be totaled when figuring their AIME, but these total earnings would be divided by 40 years times 12 months, rather than by the actual number of years the individual had worked times 12 months. For some of these workers, this would result in a higher AIME, and hence higher benefits, than under current law. The majority of beneficiaries of Social Security retirement and survivors benefits, however, would not benefit from this change and would face lower benefits as a result of inclusion of their lowest-earning years in the benefit computation.

<sup>13</sup> In addition to the provisions of H.R. 4824 and S. 2313 discussed here, provisions of these bills and of various other Social Security plans that would raise the age at which full Social Security benefits are paid could affect the benefits of some individuals who become unable to work shortly before reaching that age but are not sufficiently disabled at that point to meet the rather stringent Social Security disability test.

## How Other Social Security Plans Would Affect Disability and Survivors Benefits

Other Social Security plans that have been proposed also would affect disability and survivors benefits, although they generally would do so to a lesser degree than H.R. 4824 and S. 2313. For example, the plan introduced by Senators Daniel Patrick Moynihan and Bob Kerrey makes considerably larger reductions in the Social Security cost-of-living adjustment than do H.R. 4824 and S. 2313. Under the Moynihan-Kerrey plan, Social Security benefits would be adjusted each year by the CPI minus one full percentage point. Since disabled beneficiaries and the survivors of workers who die well before retirement age often receive benefits for a longer number of years than retirees do, this reduction in the cost-of-living adjustment would reduce their benefits substantially.

At the same time, the Moynihan-Kerrey plan does *not* contain the change in the basic Social Security benefit formula (i.e., the changes in how the primary insurance amount is calculated) that H.R. 4824 and S. 2313 include. As a result, the *overall* reduction in disability and survivors benefits is smaller under the Moynihan-Kerrey plan than under H.R. 4824 and S. 2313. The Moynihan-Kerrey plan does not need as large Social Security benefit reductions as H.R. 4824 and S. 2313 do because, over time, it diverts much less payroll tax revenue from the Social Security trust funds to individual accounts than H.R. 4824 and S. 2313.

A third plan, fashioned by former Social Security Commissioner Robert Ball, would result in small effects on disability and survivor benefits. The Ball plan modestly lowers the cost-of-living adjustment by requiring the Bureau of Labor Statistics to update every three years, rather than every 10 years, the market basket of goods and services on which the CPI is based. The expected impact of this aspect of the Ball plan on the Social Security cost-of-living adjustment would about the same as the expected impact of the cost-of-living provision of H.R. 4824 and S. 2313. The Ball plan contains no other provisions that have substantial effects on disability or survivors benefits. (The Ball plan contains much smaller Social Security benefit reductions than the Moynihan-Kerrey or NCRP proposals both because it does not divert any trust fund revenues to individual accounts and because it closes a little more than half of the 75-year Social Security financing gap by investing up to half of Social Security reserves in the equities markets and securing higher returns for the Social Security trust funds through this mechanism.)

Another plan that could affect disability and survivors benefits is a plan that Senator Phil Gramm has developed but not yet formally introduced. The Office of the Chief Actuary of the Social Security Administration has analyzed the Gramm plan, which is derived from a proposal by Harvard economist Martin Feldstein. The actuaries found that the revenue the Gramm plan allocates for Social Security disability benefits and benefits for survivors of workers who die before reaching retirement age would be insufficient. The amount that the plan allocates for these benefits is only about two-thirds of the amount the actuaries estimate would be needed to finance these benefits.<sup>12</sup> The consequences of this shortfall are unclear, but the shortfall would appear to place disability and survivors benefits at some risk unless a future Congress were willing to redirect some of the resources going into individual accounts back to the Social Security trust funds or to raise Social Security payroll taxes, the Social Security disability insurance program would face a financial crunch that could lead to significant reductions in it.

<sup>12</sup> Memorandum from Stephen C. Goss, Deputy Chief Actuary, Social Security Administration, "Considerations in Evaluating the 'Social Security Preservation Act' Proposed by Senator Phil Gramm," April 27, 1998.

provision would protect some retired, disabled and survivor beneficiaries from part or all of the benefit reductions they otherwise would face under this legislation.

Under this provision, workers who become eligible for Social Security benefits after working a minimum of *two* quarters each year between the year in which they turn 21 and the year they become disabled or die are guaranteed a minimum Social Security benefit equal to at least 60 percent of the 1996 poverty line for a single individual, adjusted for inflation. In 1998, this would equal a monthly benefit of \$400. A worker who has worked *four* quarters each year between turning 21 and the year he or she becomes disabled or dies would be guaranteed a minimum benefit equal to 100 percent of the 1996 poverty line for a single individual, as adjusted for inflation.<sup>14</sup> (The 1996 poverty line for a single individual would be adjusted by the Social Security CPI each year through 2009, and by average wage growth in years after that, to determine the poverty line figure used in computing a beneficiary's minimum benefit.<sup>15</sup>)

This provision would have a substantial impact on the benefits available to workers who earned very low wages and had strong labor force attachment. If the provision were in effect today, a worker who earned low wages before becoming disabled and who qualified for a minimum benefit equal to 100 percent of the poverty line would be guaranteed a minimum benefit of \$666 a month in 1998. This equals the monthly benefit level that a worker who has earned an average of \$14,600 per year before becoming disabled would receive under current law.

As a result, workers who worked four quarters each year between age 21 and the onset of their disability and who earned average wages of less than \$14,600 would

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<sup>14</sup> The minimum benefit provision also applies to retirees. Retirees would be eligible for a minimum benefit equal to 60 percent of the poverty line if they had worked at least 20 years and to a minimum benefit equal to 100 percent of the poverty line if they had worked at least 40 years. For retirees, the disabled, and survivors alike, once the benefit level of an individual receiving the minimum benefit has initially been set, the benefit would be adjusted for inflation in subsequent years by the Social Security CPI, just as all other Social Security benefits would be.

<sup>15</sup> Between enactment of the legislation and 2009, the minimum benefit would equal modestly less than 60 percent to 100 percent of the poverty line, due to use of the Social Security CPI rather than the regular CPI to adjust the 1996 poverty line for a single individual. The Census Bureau adjusts the poverty line each year in accordance with the regular CPI; the Social Security CPI would rise more slowly than the regular CPI. After 2009, the poverty line figure used to calculate the minimum benefit would be adjusted by average wage growth, rather than by the Social Security CPI. Average wages are expected to rise somewhat faster than the regular CPI since they generally have done so in the past. This means that the minimum benefit eventually would be set somewhat higher than 60 percent to 100 percent of the poverty line.

receive higher benefits than under current law.<sup>16</sup> The same would be true for survivors of deceased workers who had a strong labor force attachment and earned average wages of less than \$14,600.<sup>17</sup>

This provision would not benefit low earners with substantial periods out of the labor market before becoming disabled or dying, such as some women who lose some years of employment due to child-rearing or some individuals who experience a prolonged period of unemployment due to an economic downturn and become disabled or die fairly soon thereafter.

### **Finding a Solution: No Easy Answers**

In theory, the disability and survivors benefits of most disabled and survivor beneficiaries (including those not shielded by the proposed minimum benefit) could largely be protected from benefit cuts when Social Security retirement benefits are reduced. This could be done by exempting the calculation of survivors and disability benefits from the various changes in the formulas used to calculate Social Security retirement benefits.

In practice, however, using different formulas to calculate Social Security disability and survivors benefits from the formula used to calculate retiree benefits would lead to a highly inequitable distribution of benefits. Under current law, benefits are directly related to a worker's past wages. Most workers who do not collect Social Security until retirement receive a higher monthly benefit than do disabled and survivor beneficiaries, since workers who do not collect benefits until retirement have spent more years in the labor market and typically have seen their earnings rise over time. This would no longer be true if disability and survivors benefits were held harmless while retirement benefits were reduced substantially. If that occurred, a disabled beneficiary could receive substantially higher benefits than a retiree.

For example, if changes are made to the calculation of retirement benefits but disability and survivors benefits continue to be calculated as under current law, a worker who becomes disabled at age 61 would retire with unreduced Social Security

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<sup>16</sup> Under Social Security law, a worker does not have to work every quarter of the year to receive credit for four quarters of work for the year. A worker who earns \$700 in a year is credited with one quarter of work. A worker who earns at least \$2,800 in the year is credited with four quarters for that year. These earnings levels are indexed for inflation.

<sup>17</sup> The minimum benefit provision of the NCRP plan also flattens Social Security benefits across the lower part of the wage scale. Workers who had enough quarters of work to receive the minimum benefit and whose average indexed earnings over their work careers were between \$2,760 and \$19,000 on an annual basis (measured in 1998 dollars) would all receive the same Social Security benefit level.

### **Implications of Individual Account Plans for the Financing of Benefits for Disabled Workers**

The benefits of disabled workers are financed through the Social Security Disability Insurance (DI) trust fund only until workers reach the age of 65. At that point, although the workers' benefit levels remain unchanged, their benefits are financed through Social Security's other trust fund, the Old Age and Survivors Insurance (OASI) trust fund. Any Social Security reform plan that replaces some portion of Social Security retirement benefits with private accounts must take this into consideration, as the Social Security benefits of disabled workers who reach retirement age will still have to be financed through the OASI trust fund. Such a plan must provide adequate resources for the OASI trust fund to fulfill this task. This matter is of particular importance because the individual accounts of workers who become disabled well before retirement age will not have accumulated sufficient funds to provide much supplemental income.

benefits while also having accumulated a significant individual account from which to draw supplementary income. Meanwhile, a worker with a similar earnings history who retired at age 65 could have a similar-size individual account but sharply reduced Social Security retirement benefits. The two beneficiaries would have very different total benefit packages, even though both left the labor market within a few years of each other. Such an inequitable structure could prompt a significant number of individuals to leave work earlier and attempt to claim disability benefits.

At the same time, if the disability benefit calculation is *not* held harmless while benefit changes such as those in H.R. 4824 and S. 2313 are made, a worker who becomes disabled at a relatively young age would not have much of an individual account to draw upon and could face sharply reduced overall benefits.

In short, changing the calculation of Social Security retirement benefits in the manner that H.R. 4824 and S.2313 do either would result in large reductions in Social Security benefits — and overall income — for many disabled beneficiaries and survivors or would introduce substantial new inequities into the Social Security system.

The drafters of the legislation based on the NCRP plan recognized these complexities. They included a provision in their bills that would allow for later changes to be made in the disability insurance program. Under this provision, the Social Security Board of Trustees, in consultation with the National Council on Disability, would be required to submit to Congress and the President recommendations for statutory adjustments in the disability insurance program by May 31, 2001. H.R. 4824 and S. 2313 state that these recommendations may address such issues as the adequacy of benefits, the relationship of disability benefits to retirement benefits, and the process for determining initial eligibility and continued eligibility for the disability program. If the President approved the recommendations, the President

would submit them to Congress for consideration. The bill specifies procedures for resolving differences between the President and the Board if the President does not approve the Board's recommendations. It also requires that the recommendations be provided to Congress within a specified period of time if the Board and the President continue to disagree.

While this provision establishes a mechanism for consideration of possible changes in disability benefits, the fact remains that the disability benefits these bills would write into law would represent substantial reductions from the benefits that current law provides. It would take enactment of subsequent legislation to reverse these reductions.

Moreover, any recommendations to improve disability benefits submitted through this process would have to be made "...without reducing the balance ratio of the Federal Disability Insurance Trust Fund." This means the total cost of the Social Security Disability Insurance program could not increase. Any increases in restorations in Social Security disability benefits for some beneficiaries would have to be matched by offsetting reductions in Social Security disability benefits for other beneficiaries.

In addition, the Social Security trustees and other individuals who would be charged with considering and making recommendations regarding possible changes in disability benefits would face the same dilemma that the authors of H.R. 4824 and S. 2313 confronted; were it possible to shield disability benefits from the large cuts H.R. 4824 and S. 2313 make without introducing serious inequities and perverse incentives into the Social Security system, the authors of these bills would have done so. As the original NCRP report indicated, it was NCRP's goal to avoid such reductions in disability benefits. For these reasons, the provision of H.R. 4824 and S. 2313 calling for the submission of recommendations regarding disability benefits cannot be regarded as a safety clause that would ensure cuts in disability benefits are restored.

Finally, this provision would apply only to disability benefits. The legislation does not contain a similar provision establishing a mechanism for developing recommendations to ease the reductions in Social Security benefits provided to survivors of workers who have died before retiring.

## **Conclusion**

Under the Social Security benefit structure, the formulas used to determine disability and survivors benefits are intertwined with the formula for determining retirement benefits. If Social Security retirement benefits are reduced substantially, as they generally would be under plans that shift a portion of payroll tax revenues from

the Social Security trust funds to individual accounts, disability and survivors benefits are likely to be reduced substantially as well.

The legislation based on the proposal developed by the National Commission on Retirement Policy illustrates this problem. Commission members intended and desired that disability benefits not be reduced as a result of their plan. But despite their efforts and intentions, they were unable to fashion their plan in a manner that would avert substantial reductions in the basic monthly benefits on which many disabled workers and survivors of deceased workers depend.

## The Arc of the United States Governmental Affairs Office

1730 K Street, NW, Suite 1212  
Washington, D.C. 20006-3868  
(202) 785-3388 • FAX (202) 467-4179 • TDD (202) 785-3411-4179  
E-mail: [arcga@radix.net](mailto:arcga@radix.net)

### Fact Sheet Title XX Social Services Block Grant

#### **Background:**

The Social Services Block Grant is the major source of funding for all social services programs in the states. It was designed to give considerable flexibility to states to assist individuals to achieve self-sufficiency, prevent abuse and neglect, prevent inappropriate institutional care by providing community-based services.

Nearly half a million people with disabilities receive support every year through Title XX funding. Services for people with disabilities include early intervention, crisis intervention, adult day programs, employment services and independent living services. These programs assist families to keep their children at home and out of expensive institutions and enable people to live in the community as independently and productive as possible.

In 1984 Congress enacted P.L. 98-135 *permanently* raising the SSBG authorization level to \$2.7 billion (CRS, 94-953, Feb. 5, 1998). By making the authorization level permanent, Congress intended to make the program a steady source of federal funding, unaffected by political whims. However, spending for SSBG has been cut sharply in recent years. Although SSBG was authorized at \$2.8 billion for FY 1996, Congress reduced funding to \$1.38 billion in that year. The 1996 welfare reform legislation (P.L. 104-193) subsequently reduced the authorization ceiling to \$2.38 billion through FY 2002 (a 20 percent cut). In FY 1998 Congress cut SSBG again, to \$2.29 billion. The administration requested further cuts in SSBG for FY 1999 by \$471 million to an authorization of only \$1.9 billion.

The reason given for these decreases is that there is insufficient data on how the funds are spent. However, data from FY '95 was recently entered into a new database and FY '96 data are expected to be in the system and ready to be tracked shortly.

It doesn't make sense to cut funds for a program that helps to reduce costs by providing less-expensive community-based supports.

For example in Indiana approximately \$10.5 million is used for adult day programs for people with developmental disabilities and \$4.5 million is used for early intervention services.

At least 271,000 needs go unmet, according to a recent report by The Arc on the waiting list crisis.



*a national organization  
on mental retardation*

formerly Association for  
Retarded Citizens of the United States

## Social Services Block Grant (Title XX)

### **IMMEDIATE ACTION NEEDED TODAY! (9/2/98)**

On Tuesday the Senate Labor, HHS, and Education subcommittee markup funded Title XX at \$1.9 billion. This is a cut of \$399 million below FY98 and \$480 million below its authorization level. This program has been cut too many times and cannot sustain another hit. The subcommittee bill goes to the full appropriations committee on this Thursday. That leaves today for action. The coalition is delivering a letter to appropriators today but we need help.

#### **All possible effort is needed**

- ① Call or fax a letter to each Appropriations Committee member (and copy the White House!)
- ② Call any contacts you have on appropriations and see if they will make an amendment to the bill to restore funding.
- ③ Have your members call their Senators on Appropriations

#### **The message to appropriators is simple:**

"Please protect the lives of children, families, the elderly, and persons with disabilities by doing everything possible to make sure Title XX is not cut."

#### **Senate Appropriations Committee**

**Republicans:** Stevens-Alaska, Cochran-Mississippi, Specter-Pennsylvania, Domenici-New Mexico, Bond-Missouri, Gorton-Washington, McConnell-Kentucky, Burns-Montana, Shelby-Alabama, Gregg-New Hampshire, Bennett-Utah, Campbell-Colorado, Craig-Idaho, Faircloth-North Carolina, Hutchinson-Texas.

**Democrats:** Byrd-West Virginia, Inouye-Hawaii, Hollings-South Carolina, Leahy-Vermont, Bumpers-Arkansas, Lautenberg-New Jersey, Harkin-Iowa, Mikulski-Maryland, Reid-Nevada, Kohl-Wisconsin, Murray-Washington, Dorgan-North Dakota, Boxer-California

Please contact Kathryn 223-3447 or John 682-0100x237 with any updates or feedback you get from your efforts. Thanks

From Michael Loson 02

DRAFT... DRAFT... DRAFT... DRAFT... DRAFT... DRAFT... DRAFT... DRAFT...

Dear :

The President's FY 1999 proposed budget for the Social Security Administration (SSA) includes two new "user fees" which would undermine the ability of people with disabilities to find representation for their Social Security and SSI disability claims. The CCD Social Security Task Force urges you to oppose any proposed legislation incorporating the user fees because they will limit the ability of people with disabilities to obtain representation.

Under current law, SSA must approve all claimant representatives' fee requests in both Title II or SSI cases as a safeguard against excessive fees. In addition, to ensure the availability of representation to all claimants who seek it, SSA has been required since 1965 to withhold a portion of a claimants' past due Title II benefits and to make direct payment of the approved fee to the attorney. We believe that these provisions of current law assist claimants in finding attorneys willing to take their cases, even though the cases may be time-consuming and result in relatively low fees.

The President's proposal would authorize SSA to (1) charge all representatives a user fee of \$40 for fee approvals in any Title II or SSI case with a successful outcome; and (2) charge a claimant's attorney an additional \$125 fee for using the direct payment system.

If these user fees are imposed on claimants' representatives, many people with disabilities will be unable to obtain representation to appeal the denial of their claims for Title II and SSI disability benefits. The disability determination and adjudication system is a complex, multi-level process, involving the evaluation of medical and vocational factors. The process simply is too complicated for many claimants to navigate on their own. Many seek representation only after their own efforts to pursue applications have resulted in denial of their claims.

Since the representatives' fees in many cases are not high enough to absorb the cost of the user fees, many attorneys will be forced to leave this area of practice. As a result, claimants will find fewer representatives who are willing to help them obtain the benefits to which they are entitled. In addition to dealing with their own physical or mental impairments and difficult financial circumstances, they will be left to fend for themselves with SSA.

It is important to note that these user fees will be imposed only in situations where SSA wrongfully denied a claim, forcing the claimant to seek representation. Furthermore, the \$125 fee for direct payment of the approved amount (more than 3 times the fee for approval of the amount) has the appearance of a penalty on the use of an attorney to represent a claimant.

We urge you to reject the imposition of user's fees in Social Security procedures for fee approval and direct payment in claims representation.

Sincerely,

(co-chairs)

Edna Velenske  
216-0030

NATIONAL ORGANIZATION OF  
SOCIAL SECURITY CLAIMANTS' REPRESENTATIVES  
(NOSSCR)  
6 PROSPECT STREET  
MIDLAND PARK, NEW JERSEY 07432

NANCY G. SHOR  
EXECUTIVE DIRECTOR

BARBARA R. SILVERSTONE  
STAFF ATTORNEY

ETHEL ZELENKE  
DIRECTOR GOVERNMENT AFFAIRS

(201) 444-1415  
(800) 431-2804  
FAX: (201) 444-1823

February 18, 1998

**SSA's Budget Proposal**

The President's budget proposal includes two new "user fees." Each seriously undermines the ability of people with disabilities to retain representation for their Social Security and SSI claims.

**"User Fee" for Approving Fees**

In the first part, SSA would charge a "user fee" of \$40 for fee approvals in every Social Security and SSI case with a successful outcome. The current statute already requires that a fee approval be obtained in every case. The purpose of this fee regulation is to protect claimants from excessive charges. The work is part of the agency's mission and its cost should be borne by the agency. It is totally unreasonable to expect claimants' representatives to pay this fee. The workload itself is quite minimal because 80% of fee requests utilize the streamlined fee agreement process. The proposal is especially unreasonable in SSI cases where many claimants ultimately decide not to pay for the legal services provided.

**"User Fee" for Direct Payment of Fees**

In the second part, SSA intends to charge a "user fee" of \$125 for withholding a portion of the successful Social Security claimant's past-due benefits and making direct payment of the approved fee to the attorney. Since 1965, the statute has required this withholding and direct payment mechanism, as a means to insure the availability of representation for claimants who want it. That process has largely been successful, although the timeframes for payments to both claimants and attorneys have slowed drastically in the past two years.

The imposition of a "user fee" at the rate of \$125 per case is simply unconscionable. There is no way that the cost of calculating 25% of a past-due award and sending a check in that amount to an attorney could possibly cost \$125. Attorneys' fees in Social Security cases are not high enough to absorb this additional cost. There seems little question that this "user fee" will drive attorneys out of this area of practice, leaving claimants unable to obtain

representation in these cases which are obviously of crucial importance to them and their families. The capacity of many law firms and individual lawyers to provide *pro bono* representation, particularly to disabled children in SSI cases, will vanish.

The concept of a "user fee" for direct payment need not be rejected out-of-hand. We suggest consideration of a reasonable fee of \$25 to be charged only where payment to claimant and attorney is made within 45 days of the award certificate (SSA's own processing goal). SSA could not impose its "user fee" on any payments outside that timeframe. Alternatively, we suggest consideration of a reasonable fee of \$25 to be charged for SSA's timely issuance of a joint check. Additionally, we suggest that the withholding and direct payment mechanism, along with the \$25 user fee, be extended to Supplemental Security Income claims, so that SSI claimants will have the same access to representation that Title II claimants currently enjoy.

Unfortunately, it is clear that the disability determination system has become far too complex for most claimants and their families to successfully navigate on their own. Imposition of these two "user fees" will drive attorneys away from this practice. The tragic result will be that children and adults with disabilities will find themselves unable to obtain knowledgeable representation. With so much on the line for themselves and their families, this outcome is simply unacceptable.

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Trust Funds—Continued

THE BUDGET FOR FISCAL YEAR 2000

## FEDERAL DISABILITY INSURANCE TRUST FUND—Continued

## Object Classification (in millions of dollars)—Continued

| certification code 20-8007-2-7-651 | 1998 actual | 1999 est. | 2000 est. |
|------------------------------------|-------------|-----------|-----------|
| 99.0 Subject to direct obligations | 49,825      | 51,209    | 56,366    |
| 99.5 Below reporting threshold     | 1           | 1         | 2         |
| 99.9 Total new obligations         | 49,826      | 51,210    | 56,368    |

FEDERAL DISABILITY INSURANCE TRUST FUND  
(Legislative proposal, not subject to PAYGO)

## Program and Financing (in millions of dollars)

| certification code 20-8007-2-7-651                    | 1998 actual | 1999 est. | 2000 est. |
|-------------------------------------------------------|-------------|-----------|-----------|
| <b>Obligations by program activity:</b>               |             |           |           |
| 16.00 Total new obligations subject to PAYGO          |             |           | 3         |
| <b>Budgetary resources available for obligations:</b> |             |           |           |
| 22.00 New budget authority (gross)                    |             |           | 3         |
| 73.95 Total new obligations                           |             |           | -3        |
| <b>New budget authority (gross, detail)</b>           |             |           |           |
| 60.05 Appropriation (undefined)                       |             |           | 3         |
| <b>Change in unpaid obligations:</b>                  |             |           |           |
| 73.10 Total new obligations                           |             |           | 3         |
| 73.20 Total outlays (gross)                           |             |           | -3        |
| <b>Outlays (gross, detail)</b>                        |             |           |           |
| 86.97 Outlays from new permanent authority            |             |           | 3         |
| <b>New budget authority and outlays:</b>              |             |           |           |
| 89.00 Budget authority                                |             |           | 3         |
| 91.00 Outlays                                         |             |           | 3         |

This schedule reflects the effects of the Administration's proposal to impose a user fee on attorneys for Social Security claimants. This monetary assessment would be imposed only if the claimant being represented is awarded past due benefits and a fee for representation is processed by the Agency and paid to the attorney directly. An assessment would not be imposed if the representative does not charge a fee for services. The purpose of the fee is to cover the administrative costs SSA incurs when performing this service for attorneys. Language will be provided to the appropriations and authorizing committees.

This schedule also reflects the program effects of the Administration's proposal to eliminate Social Security wage credits for non-monetary compensation to military personnel.

This schedule also reflects the program effects of an extension of the Disability Insurance program demonstration project authority.

This schedule also reflects the program effects of proposals to improve SSA's access to information on imprisonment or death and increase penalties for fraud.

This schedule also reflects the program effects of a proposal to increase flexibility in Medicaid.

This schedule also reflects the program effects of a proposal to prohibit work activity from triggering a continuing disability review in the first 24 months an individual is eligible for DI benefits.

## LIMITATION ON ADMINISTRATIVE EXPENSES

For necessary expenses, including the hire of two passenger motor vehicles, and not to exceed \$10,000 for official reception and representation expenses, not more than [\$5,996,000,000] \$6,221,000,000 may be expended, as authorized by section 201(g)(1) of the Social Security Act, from any one or all of the trust funds referred to therein: Pro-

vided, That not less than \$1,600,000 shall be for the Social Security Advisory Board: *Provided further*, That unobligated balances at the end of fiscal year [1999] 2000 not needed for fiscal year [1999] 2000 shall remain available until expended to invest in the Social Security Administration computing network, including related equipment and non-payroll administrative expenses associated solely with this network: *Provided further*, That reimbursement to the trust funds under this heading for expenditures for official time for employees of the Social Security Administration pursuant to section 7131 of title 5, United States Code, and for facilities or support services for labor organizations pursuant to policies, regulations, or procedures referred to in section 7135(b) of such title shall be made by the Secretary of the Treasury, with interest, from amounts in the general fund not otherwise appropriated, as soon as possible after such expenditures are made).

[From funds provided under the previous paragraph, notwithstanding the provision under this heading in Public Law 105-78 regarding unobligated balances at the end of fiscal year 1998 not needed for such fiscal year, an amount not to exceed \$50,000,000 from such unobligated balances shall, in addition to funding already available under this heading for fiscal year 1999, be available for necessary expenses.]

From funds provided under the first paragraph, not less than \$200,000,000 shall be available for conducting continuing disability reviews.

[From funds provided under the first paragraph, the Commissioner of Social Security shall direct \$6,000,000 for Federal-State partnerships which will evaluate means to promote Medicare buy-in programs targeted to elderly and disabled individuals under titles XVIII and XIX of the Social Security Act.]

In addition to funding already available under this heading, and subject to the same terms and conditions, [\$355,000,000] \$405,000,000, to remain available until September 30, [2000] 2001, for continuing disability reviews as authorized by section 103 of Public Law 104-121 and section 10203 of Public Law 106-33. The term "continuing disability reviews" means reviews and redeterminations as defined under section 201(g)(1)(A) of the Social Security Act as amended.

In addition, [\$75,000,000] \$80,000,000 to be derived from administration fees in excess of \$5.00 per supplementary payment collected pursuant to section 1616(d) of the Social Security Act or section 212(b)(3) of Public Law 83-66, which shall remain available until expended. To the extent that the amounts collected pursuant to such section 1616(d) or 212(b)(3) in fiscal year [1999] 2000 exceed [\$75,000,000] \$80,000,000, the amounts shall be available in fiscal year [2000] 2001 only to the extent provided in advance in appropriations Acts.

From amounts previously made available under this heading for a state-of-the-art computing network, not to exceed \$100,000,000 shall be available for necessary expenses under this heading, subject to the same terms and conditions. (Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 1999, as included in Public Law 105-377, section 201(f).)

## Program and Financing (in millions of dollars)

|                                                                 | 1998 actual | 1999 est. | 2000 est. |
|-----------------------------------------------------------------|-------------|-----------|-----------|
| <b>Obligations by program activity:</b>                         |             |           |           |
| Direct program                                                  | 6,460       | 6,595     | 6,826     |
| Reimbursable program                                            | 72          | 73        | 39        |
| Total obligations                                               | 6,462       | 6,734     | 6,865     |
| <b>Budgetary resources available for obligations:</b>           |             |           |           |
| Unobligated balance available, start of year:                   |             |           |           |
| Appropriation U.S. securities: Per value                        | 489         | 390       | 129       |
| New budget authority (gross)                                    | 6,430       | 6,465     | 6,745     |
| Recovery of prior year obligations                              | 4           |           |           |
| Unobligated balance expiring                                    | -51         |           |           |
| Total budgetary resources available for obligations             | 6,872       | 6,855     | 6,865     |
| New obligations                                                 | 6,462       | 6,734     | 6,865     |
| Unobligated balance available, end of year:                     |             |           |           |
| Appropriation U.S. securities: Per value                        | 370         | 170       |           |
| <b>New budget authority (gross, detail)</b>                     |             |           |           |
| Limitation on administrative expenses (LAE)                     |             |           |           |
| Appropriations                                                  | 6,119       | 6,071     | 5,911     |
| Transfer to Office of Inspector General pursuant to P.L. 105-78 | -1          |           |           |

This schedule also reflects the program effects of the Administration's proposal to eliminate Social Security wage credits for non-monetary compensation to military personnel.

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Act, 1939, as included in Public Law 105-277, section 101(D)

#### Program and Financing (in millions of dollars)

|                                                                       | 1978 actual | 1979 est. | 2001 est. |
|-----------------------------------------------------------------------|-------------|-----------|-----------|
| <b>Obligations by program activity:</b>                               |             |           |           |
| Direct program .....                                                  | 6,460       | 6,695     | 6,425     |
| Reimbursable program .....                                            | 22          | 39        | 39        |
| Total obligations .....                                               | 6,482       | 6,734     | 6,465     |
| <b>Budgetary resources available for obligation:</b>                  |             |           |           |
| Unobligated balance available, start of year:                         |             |           |           |
| Appropriations U.S. securities, for other .....                       | 425         | 390       | 124       |
| New budget authority (gross) .....                                    | 6,430       | 6,465     | 6,745     |
| Recovery of prior year obligations .....                              | 4           |           |           |
| Unobligated balance expiring .....                                    | -51         |           |           |
| Total budgetary resources available for obligation .....              | 6,877       | 6,855     | 6,865     |
| New obligations .....                                                 | 6,482       | 6,734     | 6,465     |
| Unobligated balance available, end of year:                           |             |           |           |
| Appropriations U.S. securities, for other .....                       | 390         | 120       |           |
| <b>New budget authority (gross), detail:</b>                          |             |           |           |
| <b>Limitation on administrative expenses (AD):</b>                    |             |           |           |
| Appropriations .....                                                  | 6,119       | 6,071     | 6,300     |
| Transfer to Office of Inspector General pursuant to P.L. 105-78 ..... | -1          |           |           |

**The Arc of the United States****Governmental Affairs Office**

1730 K Street, NW, Suite 1212

Washington, D.C. 20006-3868

(202) 785-3388 • FAX (202) 467-4179 • TDD (202) 785-3411-4179

E-mail: [arcga@radix.net](mailto:arcga@radix.net)**FAX FORM (COVER SHEET)**

SENT BY:

☐ Paul Marchand☐ Evelyn Powell☐ URGENT☒ Marty Ford☐ Brenda Walker☐ PLEASE COMMENT☐ Kathy McGinley☐ FYI☐ Kim MushenoDATE: 12/11/98TO: Jonathan YoungFAX #: 456-6218NUMBER OF PAGES (INCLUDING COVER SHEET): 2

DOCUMENT DESCRIPTION: \_\_\_\_\_

REMARKS: \_\_\_\_\_

*a national organization  
on mental retardation*formerly Association for  
Retarded Citizens of the United States

# Consortium for Citizens with Disabilities

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December 11, 1998

Mr. Gene Sperling  
Director, National Economic Council  
Old Executive Office Building  
Washington, DC 20505

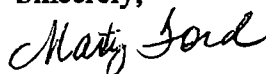
Dear Director Sperling:

On behalf of the Consortium for Citizens with Disabilities Task Force on Social Security, I want to thank you for inclusion of the concerns of people with disabilities in this week's White House Conference on Social Security and for the inclusion of several representatives of the disability community in the meetings.

In follow-up to the dialogue begun at the conference, I am requesting a meeting with you, or your designee, with a small group of representatives of CCD. We would like to discuss in more detail the issues for people with disabilities in the current debate about privatization and the various proposals designed to pay for the costs of privatization.

We believe that it is critical to have this discussion as soon as possible, particularly before the Christmas holidays. I can be reached at The Arc, 202/785-3388. I look forward to hearing from you.

Sincerely,



Marty Ford  
Co-Chair, Social Security Task Force

bcc: Jonathan Young

# The Arc of the United States Governmental Affairs Office

1730 K Street, NW, Suite 1212  
Washington, D.C. 20006-3868  
(202) 785-3388 • FAX (202) 467-4179 • TDD (202) 785-3411  
E-mail: [arcga@radix.net](mailto:arcga@radix.net)

## PEOPLE WITH DISABILITIES HAVE A STAKE IN SOCIAL SECURITY REFORM

### Old Age, Survivors, and Disability Insurance

A common myth is that Social Security is just for people who have retired. The public debate has centered almost exclusively on Social Security retirement. However, the impact that any Social Security reform might have on the disability insurance program and the protections for survivors and dependents must also be included in any discussions concerning the future of Social Security.

People with disabilities believe it is critical to remember that the Title II old age (retirement), survivors, and disability insurance programs are **insurance programs**, earned through payment of FICA taxes, designed to remove risk from certain life events for the individual. They insure against poverty in retirement years; they insure against disability limiting a person's ability to work; and they insure dependents and survivors of workers who become disabled, retire, or die by providing a basic safety net. While retirement years can be anticipated, disability can affect any individuals and families unexpectedly at any time.

People with disabilities benefit from the Title II trust funds under several categories of assistance. Those categories include:

- disabled workers, based on their own work histories, and their dependents;
- retirees with benefits based on their own work histories;
- adult disabled children of disabled workers;
- adult disabled children of retirees; and
- adult disabled children who are survivors of deceased workers or retirees.

In fact, more than one-third of all Social Security benefits are paid to non-retirees: people with disabilities, children, and widow(er)s. For the average wage earner with a family, Social Security insurance benefits are equivalent to a \$300,000 life insurance policy or a \$200,000 disability insurance policy.

Beneficiaries with disabilities depend on Social Security for a significant proportion of their income. About 21 percent of beneficiaries with disabilities live in poverty, compared with rates of 13 to 15 percent for the general population in the early 1990s. The recently conducted National Organization on Disability - Harris Poll revealed significant data on employment of people with disabilities: 71 percent of working age people with disabilities are not employed, as compared to 21 percent of the non-disabled population. The capacity of beneficiaries with disabilities to work and to save for the future and the reality of their higher rates of poverty must be taken into consideration in any efforts to change the Title II programs.



*a national organization  
on mental retardation*

formerly Association for  
Retarded Citizens of the United States

## **Privatization Proposals**

Privatization of the Social Security trust funds would shift the risks that are currently insured against in Title II from the federal government back to the individual. This could have a devastating impact on people with disabilities and their families as they try to plan for the future. The basic safety nets of retirement, survivors, and disability insurance would be substantially limited and individuals, including those with limited decision-making capacity, would be at the mercy of fluctuations in the financial markets. (Some policymakers have suggested that the federal government should take the responsibility of investing a portion of the retirement and disability trust funds in the private market with careful controls on decision-making. Since this proposal would not shift investment risk to individuals, we do not consider this "privatization" and have not opposed such investment.)

In addition, many proposals to address the very high transition costs associated with privatization would negatively affect the disability programs. Some of the proposals would make drastic cuts in benefits in the disability insurance program and significantly reduce, if not eliminate, the value of protections for the dependents and survivors of covered workers. Other proposals simply do not address the disability programs and seem to ignore the impact of other changes on people with disabilities, such as changes in the benefit formula.

## **Proposals to Reform Social Security**

As discussions move forward, regardless of the proposal, people with disabilities must be included in analysis of the impact. It is imperative that policymakers ensure:

- Meaningful inclusion of people with disabilities and their families in discussions about the solutions to the Social Security Trust Funds projected shortfall.
- Preservation of the guarantees inherent in the disability insurance program and the protections for survivors and dependents in the Old Age, Survivors, and Disability Insurance programs of Title II of the Social Security Act.
- Protection of the integrity of the benefits provided (benefits must be at a reasonable level for support) and protection of the value of benefits (benefits must be indexed for inflation to protect their buying power).

## **Other Concerns**

Finally, people with disabilities are concerned that the Supplemental Security Income program could potentially be affected by whatever actions are taken regarding the Title II benefit programs. For example, if there were reductions in benefits for retirees and people with disabilities, under current law, the SSI program would have to step in to support many of those who are forced further into poverty. We urge great caution in changes which might affect the SSI program

December 1998

Contact: Marty Ford, The Arc of the United States, (202) 785-3388

NOTE: This statement also reflects the position of the **Consortium for Citizens with Disabilities** Task Force on Social Security. Approximately 100 national organizations participate in CCD; 45 national organizations participate in the CCD Social Security Task Force.



# News Release

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## SOCIAL SECURITY

### **SSA Proposes Rule Change to Enable More Disability Beneficiaries to Return to Work**

As part of the Clinton Administration's ongoing efforts to help people with disabilities re-enter the workforce, the Social Security Administration announced today that it is proposing an increase in the amount that disabled adult beneficiaries can earn while still remaining eligible for benefits from \$500 to \$700 per month.

"This is good news for many of our disability beneficiaries," commented Commissioner of Social Security, Kenneth S. Apfel. "This increase will allow more beneficiaries with disabilities to return to the workforce and enable them to lead more productive, self-sufficient lives."

Current rules state that to become eligible for Social Security Disability Insurance (DI) or Supplemental Security Income (SSI) benefits, an individual must be unable to engage in any substantial gainful activity (SGA) that exceeds \$500 per month. In addition, SGA is used as a measure in determining ongoing entitlement for DI benefits. The SGA level is set by the Commissioner through regulation.

"Many beneficiaries are leery of attempting work for fear of inadvertently crossing the SGA threshold and losing critically important cash and medical benefits," stated Commissioner Apfel.

SGA has been increased only once since 1980 and that increase occurred in 1990. The proposed increase would raise SGA to reflect the level of the growth in average wages since 1990.

(M O R E)

- 2 -

Currently, less than one half of one percent of disability beneficiaries leave the rolls voluntarily and return to work. Each year since 1991 approximately 400,000 disability beneficiaries have remained on the rolls and have participated in the workforce. The higher SGA level is expected to prompt additional beneficiaries to venture into the workforce.

SSA has been actively involved in Administration efforts to encourage citizens with disabilities to enter the workforce. In addition to the change in SGA, the Administration recently announced its support of legislation sponsored by Senators Jeffords, Kennedy, Roth and Moynihan that would eliminate work disincentives and expand the availability of health care services.

In addition, the legislation includes a "ticket" that would enable DI or SSI beneficiaries to obtain employment, rehabilitation, and/or support services that are tailored to their needs from their choice of either a public or private provider of services.

In 1999, 4.8 million disabled workers are expected to receive Social Security benefits and approximately 4.3 million disabled adults are projected to receive SSI benefits.

"As a nation, we are best served when all of our citizens have the opportunity to contribute their talent, ideas and energy to the workforce. We must continue to seek new ways to ensure that persons with disabilities can share the benefits of our economic prosperity," concluded Commissioner Apfel.

# # #

Note: Copies of most SSA press releases, as well as other Social Security information and statistics, are available at SSA's Internet site, **Social Security Online**, at <http://www.ssa.gov>.



# Fact Sheet

**SOCIAL SECURITY**  
**Kenneth S. Apfel, Commissioner**

## **SSA Proposes Rule Change to Enable More Disability Beneficiaries to Return to Work**

### **Summary of the Issue**

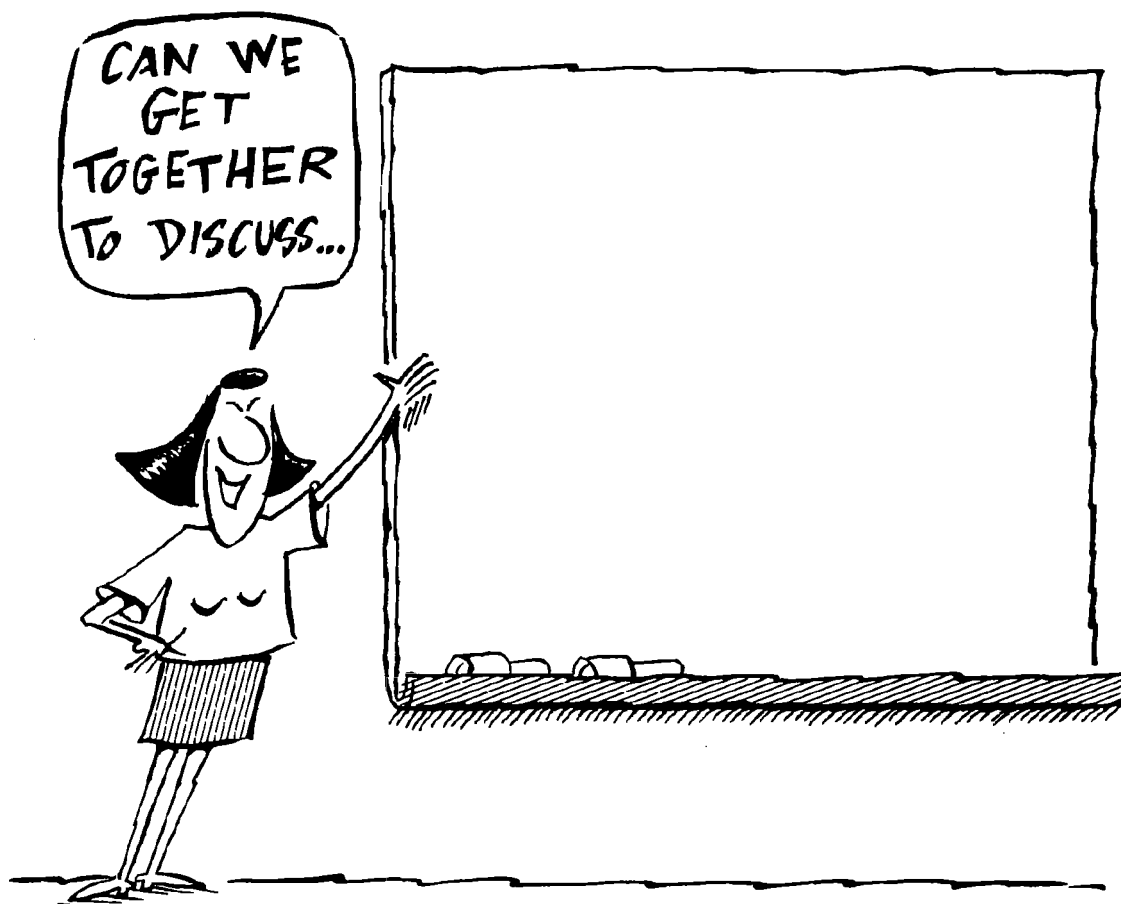
As part of the Clinton Administration's ongoing efforts to help people with disabilities reenter the workforce, the Social Security Administration is proposing a regulatory change to increase the substantial gainful activity (SGA) level for non-blind individuals from \$500 to \$700 per month. Substantial Gainful Activity is used at the time an individual applies for disability benefits as part of the process for determining whether an applicant is capable of remaining in the workforce and earning significant wages. Under current rules, once on the disability rolls, a beneficiary can earn up to \$500 a month and continue to receive cash benefits and health care coverage. The increase in SGA will allow more beneficiaries with disabilities to enter the workforce and lead more productive self-sufficient lives.

### **Background**

- SGA has been increased only once since 1980 and that increase occurred in 1990. The current level of \$500, is about \$200 below the level SGA would have attained had its growth kept pace with increases in average wages since 1990.
- Each year since 1993, approximately 400,000 disability beneficiaries have participated in the workforce. However, many beneficiaries hesitate to attempt work for fear of losing cash and medical benefits. The increase in SGA is expected to encourage more disability beneficiaries to reenter the workforce.
- In 1999, 4.8 million disabled workers are expected to receive Social Security disability benefits and 4.3 million disabled adults are projected to receive SSI benefits.
- Currently, less than one-half of one percent of disability beneficiaries leave the rolls voluntarily and return to work.

- Estimates by SSA's Office of the Actuary indicate that increasing the SGA level to \$700 would result in an approximate OASDI/SSI program cost of \$535 million for fiscal years 1999 through 2004. In addition, the increase would result in an estimated cost of \$685 million to the Medicare/Medicaid program.
- The SGA level for the blind is established by statute and is adjusted annually based on the national average wage index. Currently, the SGA level for the blind is \$1,110 per month.

## WinFax PRO Cover Page

**MESSAGE:**

Gene Sperling;

Please receive this letter from the CCD Task Force on Social Security regarding the upcoming White House Conference on Social Security Solvancy.

Tony Young

Open Access, Phone: 703.425.8633, Fax: 1-703-425-4506

To: Jonathon Young

Fax Number : 1-202-456-6218

From : Tony Young

Pages: 2

Date: 11/21/98

# CONSORTIUM FOR CITIZENS WITH DISABILITIES

November 21, 1998

Mr. Gene Sperling  
Director of the National Economic Council  
The White House  
Washington, DC 20505

Dear Director Sperling:

The Task Force on Social Security of the Consortium for Citizens with Disabilities requests the opportunity to participate in the White House Conference On Social Security on December 8 and 9, 1998. Task Force members are willing to participate as attendees, presenters, and resource persons. Please tell us what information is needed regarding the disability programs in Social Security and CCD will identify the individuals to meet that need.

The Social Security Disability Insurance (SSDI) program is a rapidly growing portion of the Old Age, Survivors, and Disability Insurance (OASDI) program. In 1997 there were 6.2 million beneficiaries with disabilities, and their dependents receiving \$16.8 billion in cash assistance, along with \$21.4 billion (FY 1996) in linked Medicare benefits. In addition, many children and adults with disabilities are reliant upon survivors and dependents insurance. These benefits are critical to individuals with physical or mental disabilities and their families who have been determined unable to work at the Substantial Gainful Activity level of \$500 per month. This is the Nation's most stringent test of disability.

The importance of disability coverage throughout the OASDI programs cannot be overstated. Millions of Americans with disabilities and their families rely on the disability programs to keep them out of poverty and Medicare benefits for basic health care. Without these programs, many individuals with significant disabilities would be homeless, impoverished, and sick.

The Task Force on Social Security of the Consortium for Citizens with Disabilities is prepared to assist you in any significant way to craft a comprehensive solution to the solvency of the OASDI Trust Funds. Please contact either Marty Ford at 202-785-3388 or Tony Young at 202-973-7112 to complete arrangements.

Sincerely,

|                                              |                   |                     |                      |
|----------------------------------------------|-------------------|---------------------|----------------------|
| <i>Marty Ford</i>                            | <i>Tony Young</i> | <i>Paul Seifert</i> | <i>Michael Losow</i> |
| Marty Ford                                   | Tony Young        | Paul Seifert        | Michael Losow        |
| The Arc of the US                            | UCP               | IAPSRs              | NISH                 |
| Co-Chairs, CCD Task Force on Social Security |                   |                     |                      |

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Date posted: 1/22/99

## The Clinton Social Security Proposal

An Analysis by Roger Hickey and Thomas Matzzie

Revised February 2, 1999

When the New Century Alliance for Social Security brought together leaders of citizen organizations in support of our Statement of Principles for the Future of Social Security, we were concerned that the public debate – and the thinking at the White House – was heading in the direction of privatization. We can and should, therefore, take considerable credit for the fact that the White House has chosen to protect, rather than dismantle the basic structure of our social insurance system. President Clinton made a clear commitment in his State of the Union address:

The best way to keep Social Security a rock-solid guarantee is not to make drastic cuts in benefits; not to raise payroll tax rates; and not to drain resources from Social Security in the name of saving it . . . We should put Social Security on a sound footing for the next 75 years. We should reduce poverty among elderly women, who are nearly twice as likely to be

poor as our other seniors.

This represents a promise to keep the Social Security system whole, and a rejection of the privatizers' idea of diverting payroll taxes to fund risky private accounts while reducing guaranteed benefits.

Everyone who has signed our Statement of Principles can embrace this fundamental aspect of the President's proposal. Most components of the President's proposal can be understood as details aimed at achieving the goal of strengthening Social Security. Some of us differ with some of these details. Some of us even dissent from the idea that major changes are required to assure Social Security's future. But every one of the leaders who have endorsed the NCA Statement of Principles can applaud and support the President's bottom line commitment to maintaining the integrity of the Social Security system. We must also continue to mobilize to make certain that the President's commitment does not erode in the attempt to get a deal passed this year. And we must continue to educate the public in the face of a torrent of miseducation and misrepresentation that is sure to come from the privatizers.

### The Clinton Proposal: Overview

What follows is an analysis of the details of the Clinton plan as they are currently known. This analysis is intended to help our allies, the press, lawmakers and the public understand and digest President Clinton's Social Security proposal.

President Clinton's Social Security proposals outlined in his State of the Union address would extend the trust fund solvency date by 23 years to the year 2055. Social Security Administration estimates indicate that they would eliminate nearly two thirds of the projected Social Security shortfall -- reducing it from 2.19% to 0.76% of covered payroll. While President Clinton has rejected privatization, his specific proposals require serious and careful scrutiny. They offer hope, raise important questions, but most importantly they begin the real debate about how to prepare Social Security for the future. This is the debate that Americans need and deserve. The polarized conflict over privatization has offered little opportunity for this discussion.

### The Details of President Clinton's Social Security Proposal

#### I. Using the Budget Surpluses

The President proposes diverting 62% of projected budget surpluses over the next 15 years to the Social Security trust funds. The White House

projects a surplus of roughly 4.4 trillion dollars over the next 15 years. The President's proposal appears to mean that 62% of these surpluses –roughly 2.7 trillion dollars – would be scored as an outlay and credited into the OASDI trust funds. According to the White House, this would not be contingent upon these surpluses materializing. Rather, a schedule of deposits from the budget into the trust funds would be enacted. According to Brookings scholar and former CBO Director Robert Reischauer this would occur under a new budget rule.

Under current budget rules, deposits into the trust funds are not scored as an outlay in the budget. FICA revenue accounts for the bulk of the projected unified budget surpluses, while simultaneously being counted as part of the Social Security trust funds. The percentage of surpluses dedicated to Social Security in the proposal is almost identical to the amount of surpluses generated from FICA revenue. So, critics will say that the plan would have the trust funds benefit from the Treasury metaphorically counting the money twice. However, it is still a legitimate policy choice for the Treasury to "write a check" to the OASDI trust funds out of the budget. In the past, when Congress has spent these Social Security surpluses on any number of expenditures, it was not criticized as double counting. Several economists – from progressives like economist Dean Baker to some conservatives like Herb Stein of the American Enterprise Institute – have proposed that this use of the surplus be considered.

Since simply holding the money would erode its value, in exchange for paying down two thirds of the public debt over the next 15 years, the trust funds would be issued special issue government bonds. This would enlarge the size of the trust funds and enhance their ability to pay benefits into the future. The size of the public debt will decrease while the overall debt (which includes trust funds) would remain stable. These larger trust funds imply that Social Security will be funded in the future in part by general revenues – which are financed by progressive taxes.

This specific proposal accounts for the bulk of improvements in the health of the trust funds. It would add 2.7 trillion dollars plus interest to the trust funds. Social Security benefit payments are projected to exceed tax revenue in the year 2013. At that time, interest on the trust funds will be drawn to pay benefits until the year 2021 when the special issue bonds will first be redeemed – with general revenues – and would be used to pay benefits. Trust fund assets are projected to peak in the year 2020 at just under 3.8 trillion dollars. Under current estimates, the trust funds would be depleted by the year 2032 and tax revenue would be sufficient to pay nearly 75% of benefits. Official estimates indicate that the President's proposal to use budget surplus funds would extend the life of the trust

funds by 17 of the total 23 additional years (or until the year 2049 instead of 2032).

## II. Managing Part of the Trust Fund Like a Pension Fund

The President has also proposed that one quarter of future Social Security cash reserves be invested in an index of stocks to be privately managed and overseen by an independent board. This policy choice is similar to proposals by Robert Ball and Brookings scholars Henry Aaron and Robert Reischauer. Their proposals would invest 50% of the OASDI trust funds in stock index funds. The President's proposal would invest a much smaller portion – around 15% of assets. Other defined benefit pensions, both public and private, have as much as 60% or more of their assets in the stock market. Under the Clinton proposal, the Social Security system would eventually have a stake in approximately 4% of the stock market. This is considerably less than the 10% of the market that other public pensions own.

This is not unprecedented. The federal government has a significant stake in the market through the Federal Employees Retirement System, through other federal pension systems and through the Pension Benefit Guaranty Corporation (PBGC) which has 20 billion dollars in the stock market in order to insure defined benefit pension funds as required by the law.

The goal of this investment proposal is to increase the revenues accruing to the Social Security trust fund, and thus to help assure the financial viability – and continued benefit guarantees – of the current system. As discussed earlier, the bulk of the 23 extra years of trust fund solvency (17 years) comes primarily from crediting budget surpluses into the trust funds. According to the Social Security actuaries, managing this portion of the expanded reserves like a pension would extend the life of the trust funds by an additional six years to the year 2055.

This proposal should not be confused with privatization schemes that cut guaranteed benefits and seek to replace them by forcing workers to divert their FICA taxes into privatized accounts. Many progressives support the Ball-Aaron-Reischauer approach since it brings new money into the system and decreases the amount by which benefit levels or tax levels need to be changed. Others are concerned about the role of the government in the markets, the uncertainty of stock market returns, and the political economy created in the Social Security system.

## III. Other Changes

The President indicated that he will seek additional unspecified changes

aimed at achieving full 75 year actuarial balance. He will seek to work out these additional changes through negotiations with Members of the Congress from both parties. It is not clear what additional policy changes the President might advance. In negotiations, Republicans might be expected to demand benefit cuts or a carve-out of FICA revenue to fund privatized accounts or increases in the retirement age, most of which were explicitly rejected by the President in his speech. Additional measures that the President – and progressives – might support include: raising the cap on income subject to payroll taxes; a larger transfer from the budget surpluses; or an increase in the percentage of the trust funds invested in the market or other instruments (like 30-year treasuries). A bold move would be to apply FICA taxes to unearned income like capital gains. ?

Clearly, one strategy of privatizers in negotiation with the President could be to negotiate cuts in guaranteed benefits while increasing the funding of the new supplemental accounts, achieving privatization through the eagerness of the President to make a deal. Progressives will have to be vigilant to insure that the President holds to his promise to oppose big benefit cuts, increases in the retirement age, and tax increases for low and middle income Americans. Another important consideration for progressives will be to evaluate the impact of a reform package on various population groups.

The President did state his intention to seek two very specific changes in benefits. Both are benefit enhancements, not cuts. The first is a stated desire to reduce poverty among elderly women – particularly widows. This population group has some of the highest poverty rates among the elderly. Although the President did not exactly specify how he would do this, there are existing proposals that would seek to address this problem. Most would increase the benefits going to surviving spouses (widows). Others would increase benefits once a surviving spouse obtains an older age (i.e. age 85). Some would pay for this by decreasing benefits for married spouses; others do not specify the funding source.

*Handwritten: Good idea*

The President also stated his desire to eliminate the earnings test. This proposal would allow more beneficiaries to earn money during retirement without reducing their Social Security benefits. It has been scored by the Social Security Administration as revenue neutral in the past. While this is viewed by many as a benefit enhancement, it could have a detrimental impact on workers who retire early and live beyond average expectancy. ?

#### IV. New Supplemental Accounts

The President also proposes to create supplemental Universal Savings Accounts (USAs) outside of and in addition to Social Security using 11

percent of projected budget surpluses. These surpluses arguably are not generated by the Social Security trust funds. Most of the details are still unknown and Administration officials are quick to point out that the specifics are open to negotiation. Recent indications from the White House suggest that this will take the form of some sort of tax credit. From what is known, the funding of these accounts would take place in two steps. First, an equal amount of money would be deposited into the account for most Americans. Second, the government would match a portion of each additional dollar an individual puts voluntarily into his/her account – with larger matches going to low and moderate income workers (presumably up to a limit). Unlike a privatized account, a supplemental account does not overtly drain resources from Social Security and or change the Social Security benefit structure.

President Clinton's USA proposal can be seen as drawing attention to the real retirement crisis – the inadequacy of non-Social Security pension sources caused by poor employer pensions and lagging real wages. It is similar in concept to proposals advanced by American Prospect editor Robert Kuttner, by Robert Ball, by the 2030 Center and by economist Robert Eisner. However, some questions remain about supplemental accounts:

- ✱ Would the creation of these accounts undermine support for maintaining Social Security's benefit guarantees?
  - Will this give upper income individuals an advantage over low and moderate income workers?
  - How will the life and work patterns of women be addressed in the design of the accounts?
  - Who would manage these accounts? A central authority like under the federal Thrift Savings Plan? Or private industry?
  - What administrative costs and burdens would these accounts impose on the federal government, workers and employers?
- 1. Rather than funding private accounts, shouldn't we be using more of the budget surpluses to secure the financing of Social Security's future?
  - What other (already starved) priorities will funding for these accounts compete with?

Why not all into SS?

This last question is a very important consideration. A discussion about creating a new entitlement, like a supplemental account, arguably belongs in the budget debate, even as we think about the implications for Social Security. There are already billions of dollars of tax advantages to promote retirement savings. Even more than the incentives for home ownership.

In addition to these questions, there are two different progressive perspectives on accounts. Some argue that supplemental accounts should not be funded; instead all new money should pay for guaranteeing and enhancing Social Security benefits. Others suggest that supplemental accounts should only be funded (and in a progressive manner) if Social Security benefit guarantees are fully funded. Under the first perspective, the supplemental accounts are deemed a waste of scarce resources. Under the second, their acceptability depends upon the final details of any Social Security deal. There is a danger that the Clinton proposal could start off looking like a progressive mixture of the Ball-Aaron-Reischauer proposal and the Dean Baker-EPI proposal and, under privatizer pressures, end up looking like the Gramlich privatization plan with accounts funded by budget surpluses instead of a tax hike.

### Conclusions

Overall the Clinton proposal represents a commitment to keeping the Social Security system whole by promoting the popular notion that Social Security should provide guaranteed benefits. It rejects the privatizers' idea of diverting payroll taxes to fund risky private accounts while reducing guaranteed benefits. President Clinton's position is an important resolution to fight for Social Security. Participants in the New Century Alliance and others should applaud this pledge – and hold the President to it.

The New Century Alliance for Social Security is an alliance of concerned citizen leaders and policy experts who have signed a Statement of Principles for Social Security's Future. They are united in the belief that Social Security should be strengthened, not dismantled.

The Institute for America's Future is a center for progressive research and education founded by over a hundred prominent Americans to make the economy work for working people. The Institute is co-directed by Robert L. Borosage and Roger Hickey.

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# **PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM WHILE MAINTAINING FISCAL DISCIPLINE**

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**FEBRUARY 1999**

**TALKING POINTS:**  
**PRESIDENT CLINTON'S FRAMEWORK FOR SOCIAL SECURITY AND MEDICARE REFORM WHILE MAINTAINING FISCAL DISCIPLINE**

- **Investing the Surplus for Tomorrow: The President's Plan Reserves Nearly 90% of Surplus To Meet Long-Term Retirement Challenge.**
  - Rather than consuming the surplus for today, President Clinton's proposal reserves nearly 90 percent of the projected budget surpluses -- almost \$4 trillion -- over the 15 years to meet our long-term retirement challenge; 62% of the surpluses are reserved for Social Security, 15% for Medicare, and 12% for USA Accounts.
  - President Clinton's proposal will pay down nearly \$3 trillion of our national debt. As a result, the publicly held debt will be cut by more than two-thirds and, as a share of GDP, will fall from 44 percent today to 7.1 percent in 2014 -- its lowest level since 1917.
- **Continuing A Pro-Growth Strategy That is Working vs. Returning To The Failed Policies of Debt and Deficit: The President's Proposal Creates a Debt Reduction Lock-Box for Social Security and Medicare.**
  - In 1993, President Clinton and Congressional Democrats cut the deficit, helping create the longest peacetime economic expansion in history. President Clinton's plan will create a debt reduction lock-box for Social Security and Medicare. This is a pro-growth strategy -- maintaining fiscal discipline by cutting the national debt, which will result in higher national savings, lower interest rates, higher private-sector investment, and higher economic growth. We should not return to the failed policies of the 1980s that quadrupled the national debt and led to the highest deficit in the history of our country.
- **President Clinton Believes We Must Meet Obligations To Future Generations First -- By Reserving 77% of Surpluses for Saving Social Security and Strengthening Medicare.**
  - Republicans and Democrats agree that investing 62 percent of the surplus to strengthen Social Security is the right thing to do. Some -- even those who agree we should save Social Security -- would use the rest of the surplus for tax cuts. President Clinton believes we must meet our obligations to future generations first -- that is why must reserve 77 percent of the projected surpluses to save Social Security and strengthen Medicare. The President believes that anyone who hopes to spend the surplus -- on tax cuts or spending initiatives -- has an obligation to first tell America's families how they plan to preserve and extend the Medicare trust fund into the next century.
- **After We Save Social Security and Strengthen Medicare, We Should Provide Tax Relief for America's Families: President Clinton's Plan To Give Tax Credits for Retirement Savings in USA Accounts Will Mean Larger Tax Relief for Average Families Than The Republican Plan.**
  - The Republican tax scheme would disproportionately help the rich. According to the Citizens for Tax Justice, for the one percent of taxpayers making more than \$301,000, the average tax cut would be \$20,697 annually. But, for taxpayers making less than \$38,000, a group that includes 60% of all taxpayers, the average tax cut under the Republican proposal would be \$99 a year -- far less than the hundreds of dollars for average working families the President's USA Account proposal would provide.

## SAVING SOCIAL SECURITY NOW, WHILE MEETING AMERICA'S CHALLENGES FOR THE 21st CENTURY

In His State of the Union Address, President Clinton Put Forward His Framework To Save Social Security and Strengthen Medicare, While Meeting America's Challenges for the 21st Century. The President and Vice President's framework strengthens Social Security and Medicare by:

- **Using The Budget Surplus To Help Save Social Security And Invest A Portion In the Stock Market To Seek Higher Returns.** The President proposes to transfer 62 percent of the projected budget surpluses over the next 15 years -- \$2.8 trillion -- to the Social Security system. The President proposes to invest less than one-quarter of the transferred surpluses in the private sector to achieve higher returns for Social Security -- just as any state or local government, or private pension does -- after working with Congress to devise a mechanism to ensure that the investments are made independently and without political interference by private-sector managers with minimum administrative costs.
- **This Framework Will Save Social Security Until 2055 -- And the President Will Work With Congress To Save It Until At Least 2075.** Transferring over 60 percent of the surpluses to Social Security and investing a portion in the market will keep Social Security solvent until 2055. The President believes we must work on a bipartisan basis to make the hard-headed but sensible and achievable choices to save Social Security until at least 2075. As part of this effort, President Clinton believes that we must:
  - (1) **Reduce Poverty Among Single Women.** Reduce poverty among elderly women -- particularly widows, who have a poverty rate nearly twice the overall poverty rate for older Americans; and
  - (2) **Eliminate The Earnings Test.** Eliminate the confusing and out-dated earnings test so that we stop discouraging work and earnings among older Americans.
- **Strengthen Medicare for the 21st Century.** The President's framework reserves 15 percent of the projected surpluses for Medicare, securing Medicare until 2020. The President believes that the new resources should be utilized to achieve broader, bipartisan reforms that modernize Medicare, make it more efficient, provide for a long-overdue prescription drug benefit, and keep Medicare safe until 2020.

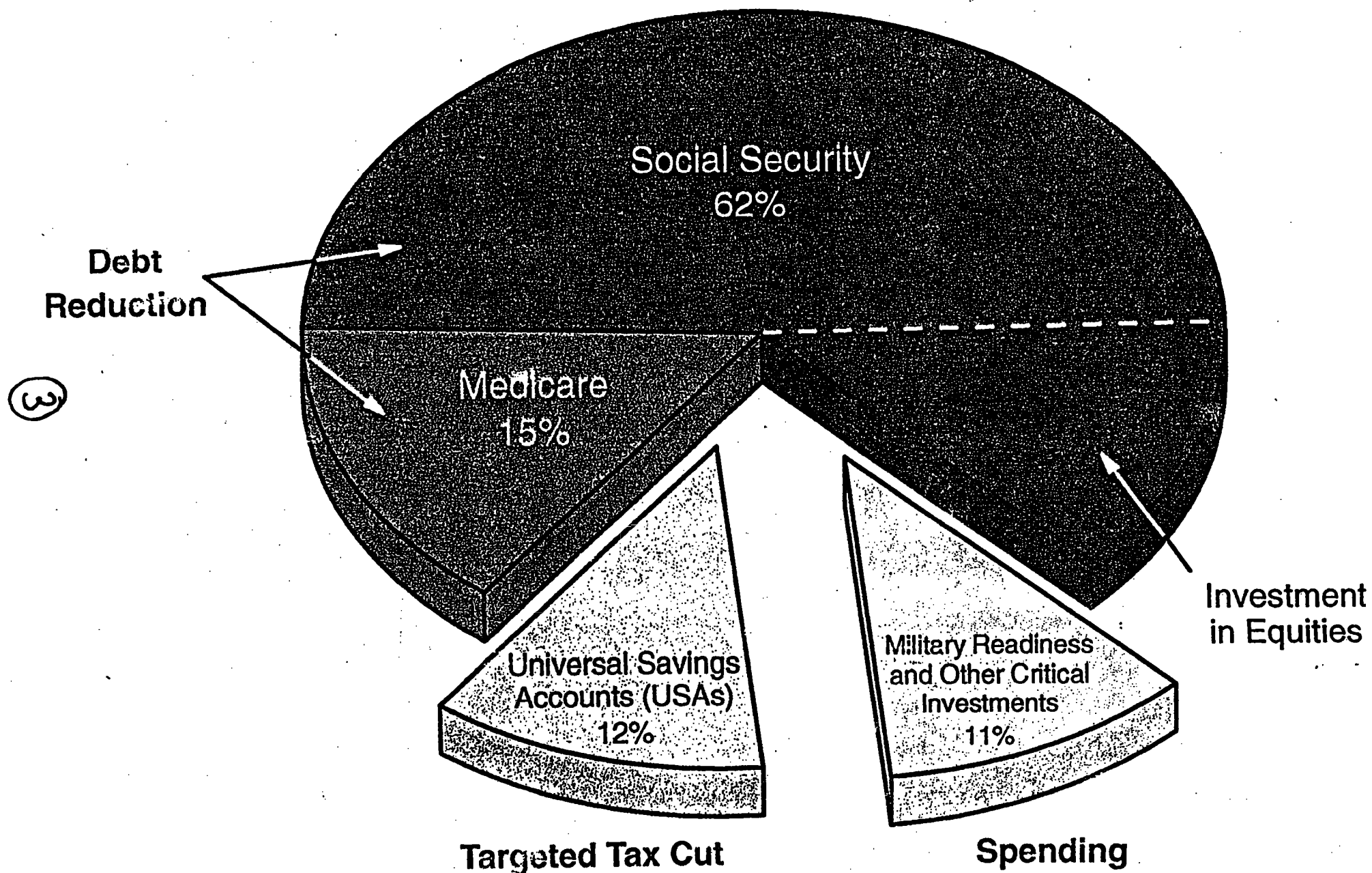
After Social Security and Medicare Reform Are Secured, President Clinton Proposes To:

- **Provide \$536 Billion in Tax Credits to Create New Universal Savings Accounts -- USA Accounts.** The President's framework will reserve 12 percent of the projected surpluses to create new Universal Savings Accounts (USAs) so working Americans can build wealth to meet their retirement needs. To help Americans save, we would provide Americans a flat tax credit to make contributions into their USA account. In addition, we would provide additional tax credits to match a portion of an individual's savings -- with more help for lower-income workers.
- **Prepare America for the Challenges of the Future.** The President's framework will reserve 11 percent of the projected surpluses for military readiness and other pressing domestic priorities.

### A FISCALLY RESPONSIBLE PROPOSAL: PUBLICLY HELD DEBT FALLS TO LOWEST LEVEL SINCE 1917

- **Debt-to-GDP Ratio Will Fall to Lowest Level Since 1917.** As a share of the economy, the publicly held debt increased from 26% in 1981 to 50% in 1993. Since President Clinton took office, the publicly held debt as a share of GDP has dropped to 44%. And under the President's framework, the publicly held debt will be cut by more than two thirds, and, as a share of GDP, will fall from 44% today to 7.1% in 2014 -- its lowest level since 1917.

# Framework for Social Security and Medicare Reform with Long-Term Fiscal Discipline



## **PRESIDENT CLINTON PRO-GROWTH STRATEGY: CUTTING THE FEDERAL DEBT TO ITS LOWEST LEVEL SINCE 1917**

**In the 1980s, The Federal Debt Quadrupled.** Under Presidents Reagan and Bush, the debt held by the public quadrupled. As a share of GDP, the publicly held debt increased from 26 percent in 1981 to 50 percent in 1993. When the President took office, the debt-to-GDP ratio was projected to rise to nearly 80 percent by 2003.

**Under President Clinton, America's Fiscal House Is Now In Order.** Instead of sticking with the failed policies of debt and deficit, President Clinton put in place a bold, new economic strategy to cut the deficit, lower interest rates and spur economic growth. Today, we have the first budget surplus in a generation.

**President Clinton's Proposal Will Cut Debt To Lowest Level Since 1917.** As a result of President Clinton's fiscal discipline, the publicly held debt as a share of GDP has dropped from 50 percent in 1993 to 44 percent in 1998. Under the President's framework, the publicly held debt will be cut by more than two thirds and, as a share of GDP, will fall from 44 percent to 7.1 percent in 2014 -- its lowest level since 1917.

**President Clinton's Strategy To Cut the Debt Will Help Strengthen the Economy, Cut Interest Payments, and Ensure that We Do Not Leave A Legacy of Debt to Our Children:**

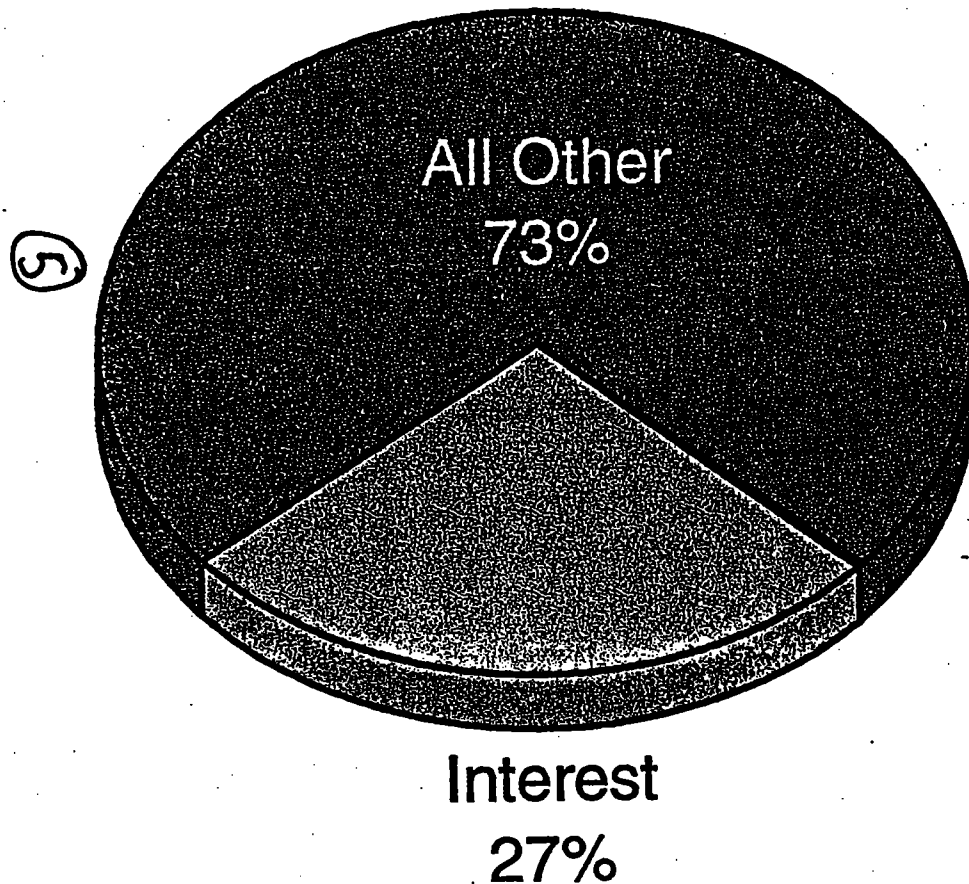
- **President Clinton's Strategy Is A Pro-Growth Strategy.** President Clinton's framework will cut the federal debt, thereby raising national savings by nearly 2 percent of GDP; Universal Savings Accounts will encourage saving even more. Higher national savings will mean lower interest rates, higher private-sector investment, and thus, higher economic growth in the future.
- **President Clinton's Strategy Will Cut Interest Payments on the Federal Debt.** When President Clinton took office, interest payments on the federal debt were projected to eat up 27 cents of every budget dollar by the year 2014. That would have made it almost impossible for future generations to make basic decisions about how the government should spend their money. Today, interest payments on the debt take up about 13 cents of every tax dollar. *Under the President's proposal, interest payments would shrink to just 2 cents on every dollar by 2014.*
- **President Clinton's Strategy Will Ensure That We Do Not Leave a Legacy of Debt to Our Children.** President Clinton's proposal would cut the debt held by the public, as a share of the economy, to 7.1 percent in 2014. This would mean that instead of leaving a mountain of debt for our children, we would completely eliminate the national debt by 2018.

### **CUTTING THE NATIONAL DEBT IS RIGHT FOR AMERICA**

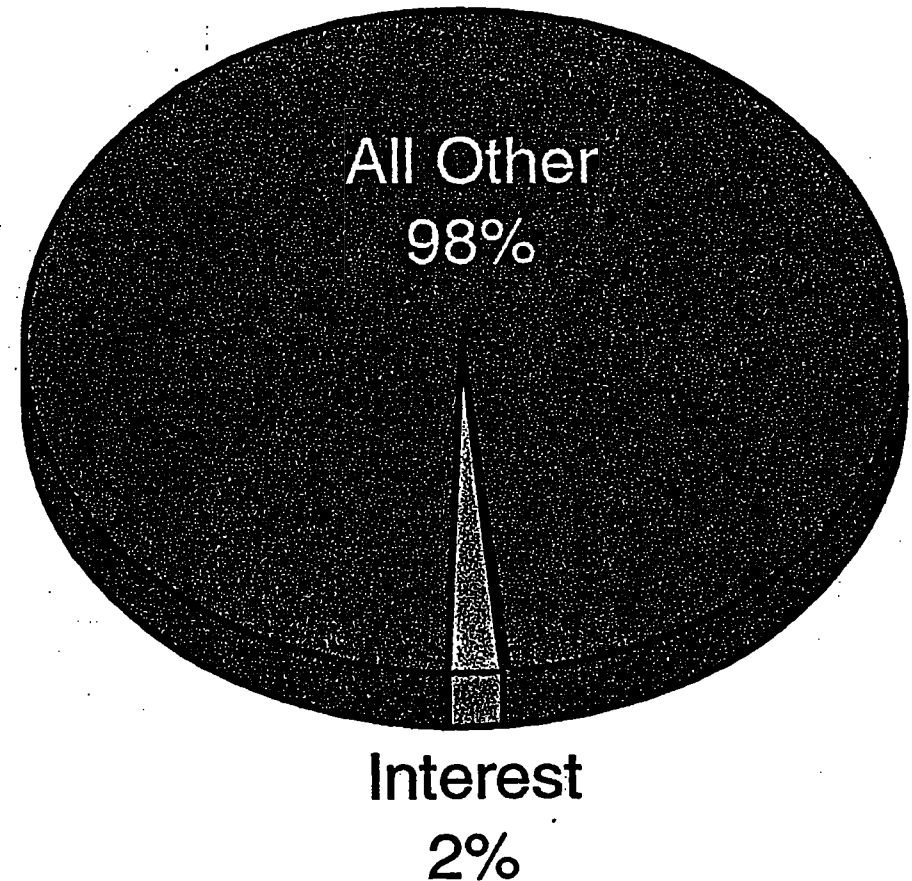
- **Alan Greenspan, Federal Reserve Chairman, January 28, 1999:** "[I]ncreasing our national saving is critical. The President's approach to Social Security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."
- **David Broder, "The Greatest Gift to our Children," *Washington Post*, February 7, 1999:** "[Saving on interest payments due on the national debt] illustrates the single biggest achievement -- and the most important virtue -- of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future. Thanks to the budget decisions he has made -- some fiercely resisted by Republicans and others urged or embraced by them -- we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses. This is a huge gain for ourselves and our children."

# Interest as a Percent of Outlays in 2014

Pre-1993 Baseline

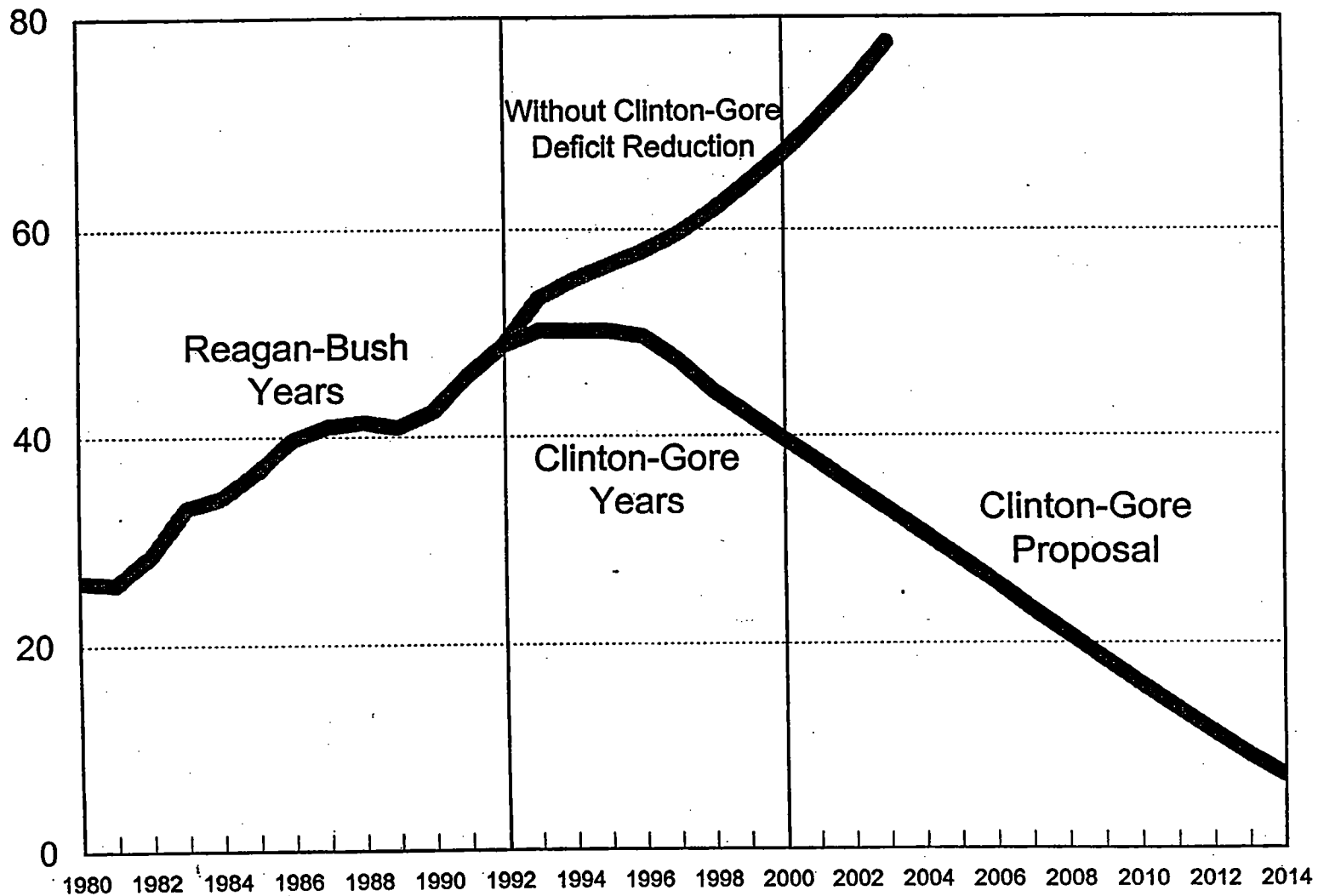


President's Proposal



# Investing The Surplus For Our Future: Cutting the Debt By More Than Two-Thirds

Ratio of Debt Held by Public to GDP  
(End of Fiscal Year)



David S. Broder

# The Greatest Gift to Our Kids

A year ago, when President Clinton offered his federal budget, the estimate of fiscal 1999 interest payments on the national debt was a bit under \$242 billion. Last week, one-third of the way through that fiscal year, the new budget estimated interest payments at just over \$227 billion.

The almost \$15 billion saving resulted from two things: a marvelous economy that generated more revenues for Uncle Sam than had seemed likely. And, second, the decision—urged by Clinton and endorsed last year by Congress—to save about 80 percent of the resulting budget surplus and use it to pay down the national debt, thereby reducing interest payments.

Now, saving \$15 billion may not seem like much in a budget of \$1.7 trillion. But let me tell you, it is equal to the whole 1999 budget of the National Institutes of Health, our pre-eminent medical research facility. It is more than the federal government will spend this year on Head Start and the main program of assistance to elementary and secondary schools. It is more than is budgeted for all of the environmental, conservation and land management programs of the government.

This illustrates the single biggest achievement—and the most important virtue—of the fiscal policy this government has pursued over the past six years, a policy which Clinton is wisely recommending be continued for the foreseeable future.

Thanks to the budget decisions he has made—some fiercely resisted by Republicans and others urged or embraced by them—we have gone from confronting deficits as far as the eye could see to the prospect of large budget surpluses.

This is a huge gain for ourselves and our children. In a time of rampant cynicism about government and politicians, this is one achievement for which Washington can take a bow. To be sure, the real heroes and heroines are in the private economy, but politicians made hard decisions to restrain spending and resist huge tax cuts, without which these numbers would not have appeared.

For years, I wrote each February about "the fastest-growing item in the federal budget—interest payments on the national debt." I argued that this was the most wasteful of all expenditures, because those interest payments, drawn from current taxes, bought us not a single weapon or school lunch. It was money down the drain—or, more accurately, into the pockets of the bondholders, foreign and domestic.

And I often quoted Sen. Pat Moynihan of New York, who regularly warned that as long as these deficits piled on each other, year after year, interest costs would "rise geometrically," threatening the well-being of future generations.

But now we have broken out of that destructive pattern and entered into what Jack Lew, the director of the Office of Management and Budget, calls "a virtuous cycle." By saving the surplus and paying down the accumulated national debt, we reduce annual interest charges at an accelerating rate.

Here's an example. The budget submitted a year ago estimated interest costs for the following five years (fiscal '99 through '03) at \$1.159 trillion. The new budget estimates interest charges for the next five years (fiscal '00 through '04) at \$977 billion—a difference of \$182 billion. That's enough to pay the salaries of everyone in the military for half that five-year period.

In the first year, the saving is \$26 billion; in the fifth year, almost twice that, \$48 billion. And it will continue to grow each year.

Now, I am not confident of long-term projections, because no one knows when we will hit an economic squall. But Lew told the Senate Budget Committee that if we stayed the course for 15 years, the national debt would shrink from half the size of the whole economy—which it was in 1992—to about 7 percent of the economy's size. Freeing them of the burden of debt would be, he rightly said, "one of the greatest gifts that we could ever give our children."

The Republican response is to divert much of the surplus into a 10 percent, across-the-board tax cut. Sen. William Roth of Delaware, the chairman of the Finance Committee, told Treasury Secretary Robert Rubin, "I find it incomprehensible that the president's plan would not allow for a wide-gauge tax cut in the next 15 years."

Rubin replied that the Treasury estimates that 35 percent of the benefits of such a tax cut would go to the top 1 percent of earners and two-thirds of the benefits to the top 20 percent—the upper-income people who are, in all other respects, doing best in our society.

That's the essence of the budget debate: Save the surplus for our kids or let the rich spend more on themselves.

THE WASHINGTON POST  
SUNDAY, FEBRUARY 7, 1999

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## SUPPORT FOR KEY ASPECTS OF PRESIDENT CLINTON'S PROPOSAL

- Henry Aaron, Brookings Institution, January 27, 1999: "The purpose of this note is to explain how the president's proposal would work from an accounting perspective. The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases. Faced with a once in-a-generation choice about how to spend large and unanticipated surpluses, the nation should confront the big issue "save the surplus or spend it" and not get mired in accounting pettifoggery."
- Alan Greenspan, Federal Reserve Chairman, January 28, 1999: "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."
- *Wall Street Journal*, "Greenspan Backs Clinton's Plan For the Surplus: Diverting General Revenues Toward Social Security Will Cut Debt," January 29, 1999: "Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.... Mr. Greenspan called Mr. Clinton's plan for the surplus 'a major step in the right direction.'"
- *New York Times*, "In the Red. No, Black. Debate Over Social Security Proposal Misfires in Focus on Double Counting," January 30, 1999: "[T]he real difference between the President's plan and that of his critics is not double counting. Some critics want to use the surplus to cut taxes. Many Republicans want to use it to create individual retirement accounts.... The President wants instead to drive down the Federal debt, now about \$4 trillion."
- *Washington Post*, "Saving Budget," February 2, 1999: "The government's long-run obligations continue to be much greater than the foreseeable revenues. The mostly conservative fiscal position that the president has staked out is correct."
- Jonathan Chait, "Who's Fiscally Responsible Now," *New York Times*, January 25, 1999: "The political genius of Mr. Clinton's plan is that it marries good policy with good politics. This used to be what Republicans called responsible budgeting. How sad that they now see it as unacceptable."



# Greenspan Backs Clinton's Plan For the Surplus

## Diverting General Revenues Toward Social Security Will Cut Debt, He Says

By JACOB M. SCHLESINGER

Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—Federal Reserve Chairman Alan Greenspan defended President Clinton's plan to divert general revenues into Social Security, suggesting that it may be the only politically possible way to use growing budget surpluses to pay down the national debt.

Republicans have stepped up criticism of the White House Social Security plan in

### Internet Exuberance?

Fed Chairman Greenspan told Congress that Internet-stock mania is like buying lottery tickets. Article on page C1.

recent days, focusing on its reliance on a massive transfusion of new tax revenues to extend the Social Security trust fund by 23 years to 2055. Currently, Social Security is funded by payroll taxes.

At a Senate Budget Committee hearing, Chairman Pete Domenici of New Mexico blasted Mr. Clinton's plan as "an elaborate game" of "accounting shifts" that will "undercut efforts to achieve real reform." Mr. Domenici noted that in prior bipartisan studies of the retirement program, one of the few points of consensus was opposition to using general revenues.

But Mr. Domenici and other Republicans were unsuccessful in repeated attempts to draw Mr. Greenspan into attacking Mr. Clinton's plan. Mr. Greenspan has in the past opposed using general revenues to fund Social Security and indicated yesterday that he wasn't happy about the idea now. But he implied that Mr. Clinton's plan—which essentially marries future Social Security commitments to current budget surpluses—may be the best political means to an end that Mr. Greenspan strongly supports: paying down the national debt of \$3.8 trillion held by the public.

The notion that Congress could rally enough support to pay down debt without such a gimmick "may be totally unrealistic," Mr. Greenspan said, adding that Mr. Clinton's approach may be a "second-best" way to accomplish that goal.

The heart of the complex debate is what Washington should—and can—do with budget surpluses that the White House estimates will total \$4.4 trillion in the next 15 years.

Many economists, most notably Mr. Greenspan, feel the money should be used to pay down debt, which they say will lower interest rates, raise national savings and investment, and boost long-term growth rates. Mr. Greenspan called Mr. Clinton's plan for the surplus "a major step in the right direction."

Republicans don't necessarily disagree. But they contend it is unrealistic to expect Washington to sit on surpluses for many years without boosting spending or cutting taxes. "If I look out there and look at Congress, they are going to spend it," Sen. Domenici said. So, he and other Republicans prefer a big tax cut. On that point, they won Mr. Greenspan's qualified endorsement: He repeated his oft-stated view that if the government can't protect surpluses, it is better to cut taxes than increase spending.

Republicans are increasingly vocal in opposing the complex way that Mr. Clinton does pay down the debt. The Clinton plan would use about \$2.8 trillion to pay down debt. For every dollar of debt paid down, Mr. Clinton would give an extra dollar of IOUs to the Social Security trust fund to pay for benefits from 2032 to 2055. Under that scenario, those benefits would essentially be paid out of general revenues.

Despite his praise for parts of Mr. Clinton's Social Security plan, Mr. Greenspan agreed with critics that it doesn't do much to solve the long-term cost problems. Mr. Clinton's proposals avoid any painful changes, and Mr. Greenspan said that ultimately, "in all likelihood . . . taxes will have to be raised, or benefits cut." Mr. Greenspan also cautioned against assuming that the White House's rosy estimates for surpluses will actually materialize.

In his testimony, Mr. Greenspan also reiterated his opposition to another portion of the Clinton Social Security plan that drew the most attention when the package was first unveiled last week: investing some of the trust fund in the stock market. "Even with Herculean efforts, I doubt it would be feasible to insulate, over the long run, the trust funds from political pressures," the Fed chairman said.

*Greenspan says  
cut taxes if only  
alternative is  
increasing spending,  
but supports  
spending down debt*

THE WALL STREET JOURNAL

FRIDAY, JANUARY 29, 1999

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- **When You Strip Away All of the Accounting Rhetoric, the President's Plan Does Two Things:**
  - (1) Between now and 2014, the President's plan will cut the publicly held debt by more than two thirds, increasing national savings and strengthening our economy to make it easier for us to meet our retirement challenge and other national priorities.
  - (2) It gives Social Security first claim on the benefits of debt reduction (by giving new bonds to the trust fund).
- **That Is Why Fed Chairman Alan Greenspan and Top Experts Support the President's Approach to Debt Reduction:**
  - Henry Aaron, Brookings Institution, January 27, 1999: "The message is simple: the double-counting issue is bogus. The president's address outlined a bold plan that stands in striking contrast to alternative proposals that would use the projected budget surpluses to justify large tax cuts or spending increases."
  - Alan Greenspan, Federal Reserve Chairman, January 28, 1999: "In this light, increasing our national saving is critical. The President's approach to social security reform supports a large unified budget surplus. This is a major step in the right direction in that it would ensure that the current rise in government's positive contribution to national saving is sustained."
- **The President's Plan Takes Advantage of Our Current Good Times to Set Aside Resources So That We Can Meet Our Existing Obligations.** We already have an obligation to current workers to pay them benefits when they retire, even if they retire in years after 2032. The President's plan does not increase these commitments. Instead, it sets aside resources so that we can meet our existing obligations.
- **Under the President's Plan, We Have the Ability to Pay Benefits Through 2032 and Beyond.** When President Clinton took office in 1993, deficits were exploding and there were serious concerns about how we were going to be able to pay back the Social Security trust fund when it began redeeming its bonds. Because of the fiscal discipline and tough choices of the past six years, the Clinton Administration is projecting budget surpluses, even after paying back Social Security, until the middle of the next century.
- **The President's Plan Follows the Same Accounting That Has Been Used by Every U.S. Administration since the Johnson Administration.** Since the Johnson Administration, the Social Security surplus has been part of the unified budget surplus, and has been used a second time, almost always for new spending. Many Republicans have called for the surplus to be used a second time for tax cuts, to fund individual accounts, or to pay for the transition to an individual account system. The President's plan uses the surpluses for debt reduction, and to extend the life of the Social Security and Medicare trust funds.
- **The Bottom Line Is Clear: The President's Plan Will Cut the Debt and Keep America's Economy Strong.** Regardless of any claims offered by opponents, the President's plan will cut the debt held by the public by more than two thirds, and as a share of the economy it will fall to its lowest level since 1917. This will raise national savings, lower interest rates, and help keep America's economy strong. The President's plan will lower the burden faced by our children and grandchildren, and leave the country better able to meet the challenges of an aging population.



February 22, 1999

## Washington Diarist: Doubletalk

By Jonathan Chait

The most irritating thing about newspapers is their convention of presenting disagreements on matters of fact as nothing more than differences of opinion. Recently, a city official here resigned because he used the word "niggardly." A Washington Post story reported that the word "means different things to different people." Most of the Washingtonians quoted felt it could be taken as a slur, but others did not. And who is the Post to say which side is right? The same day, another Post story reported that President Clinton's Social Security plan is in trouble; it is widely thought to be a "budgetary sleight-of-hand that actually has the effect of counting twice the money that would have gone into the program anyway." Now, it is either double-counting or it isn't, but the article did not delve into the merits of the accusation. Instead it focused on the fact that "serious questions are surfacing."

The question surfaced, among other places, in an article in last week's *tnr* by Matthew Miller. For those who missed it, Miller assumes the following scenario: The budget surplus is \$150 billion, of which \$100 billion comes from the leftover Social Security taxes that weren't used to pay for current benefits. That \$100 billion goes into the Social Security trust fund. Then Clinton takes 60 percent of the total budget surplus—\$90 billion—and gives it to the trust fund. That means the trust fund gets a total of \$190 billion. Since this is more than the total value of the budget surplus, Miller concludes that Clinton's plan "double-counts" and is also a "scam," "legerdemain," and a good dozen other synonyms.

I admit it looks strange. But there's a perfectly decent explanation. Suppose that I loan you a dollar, and you promise to pay me back with interest. The Chait trust fund is now worth one dollar. Then, out of the goodness of your heart, you decide to give me back the same dollar as a gift. Now I am worth two dollars: the dollar I have, plus the dollar you still owe me. Clinton's proposal works the same way. Social Security brings in an extra dollar that it doesn't need this year. It loans the dollar to the rest of the federal budget, and in return the federal government deposits an IOU for one dollar in Social Security's trust fund. (The trust fund is an accounting device to keep track of all the dollars Social Security has loaned out.) Now the extra dollar belongs to the non-Social Security budget, and the government can spend it any way it wants. Clinton proposes giving that dollar—60 cents of that dollar, actually, but let's keep it simple—back to the Social Security trust fund. Then the trust fund takes the dollar and purchases a \$1 federal bond from the general public. Hence, it has increased its value by more than the value of the budget surplus.

In case it sounds like I'm trying to pull a fast one, let's ponder those two transactions in turn. The first part simply involves lending the Social Security surplus to the general budget. This resembles double-counting in the sense that the money credited to the trust fund can also be used for other purposes. Yet, while the outcry in the press might make you think that Clinton invented this tactic, every federal budget has done this for decades. Indeed, the very same Republicans who are denouncing Clinton—including self-proclaimed budget hawks such as John Kasich and Pete Domenici—have themselves proposed using the budget surplus, made up largely of Social Security funds, to pay for new tax cuts or private retirement accounts.

The only new element is what Clinton proposes to do with the money after Social Security lends it to the general budget. The general budget gives most of the money right back to the

trust fund as a grant, not a loan. The trust fund takes about 15 percent of the money and gives it to an independent board to invest in stock indexes. (This part is also controversial, but I won't get into it right now.) It invests the rest of the money in Treasury bills, thus reducing the national debt. Again, this might appear suspicious--how can you use the same dollar to reduce the national debt and bolster the Social Security trust fund? The answer is that it has the same economic effect as reducing the national debt. Right now there are millions of Americans who own federal bonds--IOUs for money they've lent to Uncle Sam. When the trust fund buys up some of those bonds, the public then can use the money to spend or invest in the private sector. To the extent the money is invested in efficient new productive capacity, it strengthens the economy over the long run. Also, by reducing the debt it owes to the public, the government increases its ability to borrow in the future. The only twist is that Clinton's plan guarantees that the benefits of this saving accrue to Social Security. If this still strikes you funny, consider an alternative scenario. If Clinton took the Social Security portion of the budget surplus and spent it all on tax credits or child care or wild parties in the Oval Office, the money would still be credited to the trust fund. So, if he instead saves the money for Social Security, shouldn't the trust fund reflect the difference?

One common objection is that bolstering the trust fund cannot work because it accumulates nothing but IOUs. But the debtor on those IOUs is the United States government, the safest credit risk in the history of civilization. And the creditors are future Social Security recipients, who demonstrate roughly the same level of forgiveness toward missed payments as a loan shark from the Gambino family. Anyway, this isn't a reason to oppose Clinton's plan, which boosts the government's capacity to make good on future debts.

But Miller doesn't claim the trust fund won't be there. Instead he argues that Clinton is simply pulling money out of the sky. The "logical extension" of the Clinton plan, he writes, is "to use the same accounting trick to boost the trust fund a few extra trillion and announce that Clinton had put the Social Security problem behind us altogether." He's arguing, in other words, that Clinton's plan would have allowed him to add as much money as he wanted to the trust fund. But this is simply not the case. The most Clinton could have put into the trust fund is twice the surplus. This is a fact, not an opinion.

The president's idea might not be in so much trouble, then, if Congress and the media actually understood it. But, then again, maybe it wouldn't matter. Upon hearing that "niggardly" derives from Middle English and Scandinavian dialects, one offeree shrugged: "Do we really know where the Norwegians got the word?" Yes, maybe they anticipated that, centuries hence, the word "nigger" would become a slur in English and then subsequently become socially unacceptable, so they preemptively sneaked a similar-sounding word into the language. All I know for sure is that serious questions are surfacing.

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## THE CASE FOR INVESTING PART OF THE UNIFIED SURPLUSES IN EQUITIES

In his State of the Union Address, the President proposed that 62 percent of the projected budget surpluses over the next 15 years be transferred to the Social Security Trust Fund, in order to increase the ability of that Fund to meet promised Social Security benefit obligations. The President further proposed that about a fifth of the transferred surpluses be invested in equities to achieve higher returns for Social Security, helping to extend the life of the Social Security trust fund to 2055. This action does, however, raise understandable concerns about the possible extension of political influence on investment decisions and the risks that this might pose to the economy and the Trust Fund. Any system of collective investment can and must address these concerns. That is why we will work with Congress to design a system that observes five core principles:

1. **Private Sector Managers Selected by Competitive Bidding.** Social Security beneficiaries deserve the same efficient management and market returns that people receive in their private pensions and personal savings. The actual investments should be managed by private sector money-managers selected by competitive bidding.
2. **Independently Managed and Non-Political.** There would need to be wholly independent oversight of investment that was insulated from political influence. The choice of investment managers should be done by an independent board whose sole responsibility would be to pick fund managers so as to maximize the performance of the investments. This would ensure that the investment of funds was carried out with zero government involvement.
3. **Limited.** *are there any now?* The share of Trust Fund assets invested in equities ought to be kept at a very modest level -- both to limit risk to the Fund and to ensure that collective investments never account for more than a small fraction of the stock market as a whole.
4. **Broad-based, Neutral, and Non-Discretionary.** Assets should be invested proportionately in the broadest array of publicly listed equities, with no room for discretion in adding or deleting companies and no room for active involvement in corporate decisions. Neither the government nor the private sector managers it selects to undertake investment on its behalf should be involved in "stock picking." As a shareholder the Funds should be entirely passive; one way to accomplish this would be to mandate that proxies be voted in the same proportions as other shareholders. Alternatively, if the investments were spread among a number of managers so that no one manager had a large share of the total market, the managers could vote the shares in the interests of the share holders, just as mutual fund managers do today.  
*no stock picking! only funds*
  - **No Market Timing or Stock Picking.** In essence, the managers should be on autopilot in investing the funds. They should have little or no discretion in the investment of Trust Fund assets -- so they cannot "time the market" or pick individual stocks.
5. **Lowest-Cost.** Collective investment needs to be administratively simple and achieved at the lowest available cost -- both to obtain the highest possible returns and to further enhance the system's transparency and independence.

## WHY INVEST PART OF THE SURPLUSES IN EQUITIES?

### 1. Investing Part of the Surpluses in Equities Would Raise the Rate of Return That Workers Would Experience on Their Contributions into the Social Security System.

- Historically, the Trust Fund has been invested exclusively in government bonds. While these bonds have the upside that they are essentially risk-free, they have the downside that they pay a relatively low rate of return on average. Adding equities to the Trust Fund portfolio would allow the Social Security system to enjoy a higher rate of return, on average. Between 1959 and 1996, the difference between the average annual rate of return earned on stocks and the rate earned on bonds held by the Trust Fund -- the "equity premium" -- was 3.84 percent.
- Raising the rate of return on the Trust Fund would mean that the Social Security system could be brought into long-term actuarial balance with smaller reductions in benefits, or smaller increases in revenue, or both.
- Investing part of the transferred surpluses in equities accounts for about one-third of the improvement in the actuarial balance achieved under the President's framework.

### 2. Investing Part of the Trust Fund in Equities Would Bring Social Security into Line with the "Best Practice" of Both Private- and Public-Sector Pension Plans.

- The overwhelming number of private-sector defined-benefit pension plans invest part of their reserves in equities. Among large private-sector defined benefit plans (those with more than 100 participants), more than 40 percent of total assets of were invested in equities.
- Similarly, 65 percent of the portfolio backing the defined-benefit pension plan of the Federal Reserve System is invested in equities.
- In aggregate, state and local pension plans hold fully 10 percent of the overall stock market.

## WHY IS EQUITY INVESTMENT BETTER UNDERTAKEN THROUGH THE TRUST FUND THAN THROUGH INDIVIDUAL ACCOUNTS?

### 1. Administrative Costs Associated with Trust Fund Investment Would Be Much Lower.

- For example, the equity-fund component of the Federal Thrift Savings Plan (TSP) incurs annual investment-management costs of only about one basis point (one one-hundredth of a percentage point). Thus, for every \$100 in equity assets under management, the TSP pays only about one cent per year in management fees.

- By contrast, asset management fees for individual accounts such as IRAs typically run in the neighborhood of 100 basis points or more -- or about \$1 per year for every \$100 under management.

*The asset management fees associated with IRAs are thus typically at least 100 times larger than the fees associated with centralized investment.*

Management fees are extremely important in determining the buildup of assets. A fee of one basis point paid every year for 40 years would reduce the accumulated balance by only about 0.4 percent. By contrast, a fee of 100 basis points would reduce the accumulated balance by about 33 percent.

## 2. Financial Risk Can Be Spread Much More Effectively If Equity Investment Is Undertaken Through the Trust Fund than Through Individual Accounts.

- Financial risk that arises through equity-investment of the Trust Fund can be spread both across the entire population participating in the system at any given point in time, and over time. Indeed, provided equity investment is undertaken through the Trust Fund, the consequences of market fluctuations can potentially be spread over many generations.
- By contrast, in a system of individual accounts, the consequences of market fluctuations must -- by definition -- be borne by each individual. If the market happens to do well during a certain individual's lifetime, that individual can enjoy a relatively prosperous retirement. If the market does poorly, that individual's financial security in retirement may be jeopardized.

### WHY CAN WE BE CONFIDENT THAT TRUST FUND INVESTMENT IN EQUITIES WON'T DISRUPT THE MARKET?

#### 1. This Is Not Direct Government Investment -- It Is Investment Undertaken by Private-Sector Managers Selected by Competitive Bidding.

- A bedrock principle of the President's program is that the government itself should not be a participant in the market. All transactions will be executed by private-sector managers.
- The Thrift Savings Plan selects managers in a similar way, placing its portfolio with managers that bid the lowest cost. These managers also vote the shares of stock they control.

2. **Institutional Rules Can Be Established to Create Very Strong "Fire Walls" Against Political Interference.**

- The experience of state and local pension funds points to several elements of institutional design that have been essential in that context in helping prevent political interference.
- Investments can be made in a broad-based, neutral, and non-discretionary way. Through passive investing in an index, private-sector managers will not be involved in "stock picking."
- History shows that political influence can be avoided. The overwhelming bulk of assets in state and local plans are invested wisely -- not in politically motivated ways.
- For example, the Federal Thrift Savings Plan (TSP) invests \$77 billion in stocks and bonds, with more than half in stocks. Francis Cavanaugh, the first executive director of the Board responsible for TSP investments, says that investments have been made without political interference. Specifically, in a recent news article, Cavanaugh said, "Can it be done? It's been done... We did it."

3. **The Equity Holdings of the Social Security System under the President's Program Would Be Modest Relative to the Holdings of Other Major Players in the Market.**

- Under the President's program, the Social Security system would hold an average of about 4 percent of the aggregate U.S. stock market.
- Who? Same as Fidelity
- The top 10 largest private-sector portfolio managers all have more than one percent of the market under management. Fidelity, the largest such private-sector manager, has about 4 percent of the market under its management.
- By contrast, state and local governments in aggregate already hold about 10 percent of the market.