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Statement on

RETIREMENT EARNINGS TEST

by
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Commissioner of Social Security

Before the
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives

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Mr. Chairman and Members of the Committee:

Thank you for the opportunity to be here today to discuss the Social Security retirement earnings test. The earnings test is an issue which affects many Social Security beneficiaries and has been the subject of much debate and discussion.

The Administration shares the concerns expressed by you, Mr. Chairman, and other Members of this Committee, about the impact of the retirement test on our beneficiaries. I think that this hearing can be helpful in focusing the debate on this issue and I commend you for holding it.

To facilitate our discussion today, I will begin by briefly reviewing the philosophy behind the earnings test, and how that philosophy--and the test itself--have evolved over time. Finally, I will discuss the Administration's views on the "Contract with America" proposed modification to the retirement earnings test that calls for an increase in the annual exempt amount from $11,280 today to $30,000 in 2000 for those workers who have reached the normal retirement age.

History of the Earnings Test

Social Security was designed as a social insurance program under which workers and their dependents are insured against the loss of earnings as a result of the retirement, disability, or death of the worker. Benefits are intended to partially replace the earnings that are actually lost due to these risks. In that context, the retirement earnings test was designed as an objective measure of the extent to which earnings are lost due to retirement.

The Social Security program has always had an earnings test to measure earnings loss, although the way in which the test has been applied has changed over the years. Under the original Social Security Act of 1935, no benefits were payable for any month in which a beneficiary had any covered earnings whatsoever --no benefits were payable unless the person were fully retired from covered employment. However, even before the first benefits were paid in 1940, this strict "all-or-nothing" test of retirement was modified so that a beneficiary could earn up to $14.99 in covered earnings before losing benefits for that month.

Over the years since 1940, the retirement earnings test has been modified many times. The Social Security Amendments of 1950, for example, exempted people age 75 and over from the earnings test. In 1954, the retirement test was broadened to include non-covered wages, and the age at which the test no longer applied was lowered from 75 to 72. The concept of reducing benefits by $1 for each $2 of earnings above the exempt amount was introduced in the Social Security Amendments of 1960, and the 1972 Amendments provided for the earnings test exempt amount to be increased automatically with increases in average wage levels.

The Social Security Amendments of 1977 further increased the exempt amount for beneficiaries age 65 and over. Effective in 1983, the age at which the test no longer applies was lowered from 72 to 70.

The last major change in the test took effect in 1990, when the withholding rate of $1 of benefits for each $2 of earnings was changed to $1 for $3 for beneficiaries aged 65 to 69.

<u>The Current Retirement Test</u>

For beneficiaries ages 65 through 69, the earnings test reduces benefits by $1 for each $3 of earnings above the annual exempt amount, which is adjusted each year to reflect increased wage levels. The 1995 annual exempt amount for these beneficiaries is $11,280. Beneficiaries under age 65 lose $1 for each $2 of earnings over an exempt amount of $8,160. Unearned income--such as interest income, dividend payments, private pensions and the like--is not counted for purposes of the retirement test.

In addition, workers are exempt from the test when they reach age 70. The test does not apply to disability beneficiaries, who are subject instead to a substantial gainful activity test. It does apply to dependents of disability beneficiaries.

A worker's earnings above the exempt amount affect not only his or her own benefits, but also the benefits of family members receiving benefits on the worker's earnings record. The earnings of a dependent or survivor beneficiary can affect only that beneficiary's payments.

Delayed retirement credits (DRCs) are provided to compensate workers whose benefits are withheld under the retirement earnings test. The DRC increases the worker's retirement benefit for each month that benefits are fully withheld. The DRC is currently 4 1/2 percent per year for workers reaching age 65 in 1995. The DRC percentage will increase by 1/2 percentage point every 2 years until it reaches 8 percent per year for workers reaching age 65 in 2008 and later. When the DRC is 8 percent per year, benefits lost due to the retirement earnings test and/or delayed retirement generally will be offset by the increase in benefits resulting from DRCs for beneficiaries who reach average life expectancy.

About 925,000 beneficiaries lose some or all of their benefits as a result of the test that applies at age 65. Of this group, about 880,000 are retired-worker beneficiaries aged 65 to

69 or their dependents (any age) who receive benefits on the retired worker's record. About 45,000 are dependent or survivor beneficiaries age 65 to 69 who are affected by the test due to their own earnings.

Competing Objectives

As I have discussed, despite the original principle that benefits should be paid only to those who are fully retired, the earnings test has been modified over the years so that it is no longer such a strict test of retirement. These changes have come about from the desire to support several competing interests.

One such interest has been to allow beneficiaries to supplement their Social Security benefits with a limited amount of earnings. This option is especially important for many lower-income workers, as well as for others, especially women, whose work experience has been uneven, and is consistent with the concept that Social Security was meant to function as "one leg of a three-legged stool" that is also supported by private pensions, and individual savings and investments. Modifying the strict retirement test originally in the law has allowed retirees to supplement benefits with earnings up to a specified level, without any loss of benefits.

The second competing interest is that of preserving the incentive and opportunity among the aged to work. Given the demographics of our nation, this goal is likely to take on added importance with the aging of the baby-boom generation and the anticipated slowing in the growth of the labor force. The earnings test discourages some beneficiaries from working because the cost of working--taking into account the test itself, Social Security taxes, and Federal, State, and local income taxes, and work-related expenses--can be substantial for working beneficiaries aged 65 to 69.

The third competing interest is the desire to offer benefits that are as adequate as possible to those who need them most while maintaining the solvency of the Trust Funds. It is important that we consider who receives the benefits from any change in the earnings test and who would pay for them. In addition, although the trust funds are currently running a surplus, it is well known that this is not permanent and that we must carefully guard the use of all Trust Fund dollars.

Thus, in the way it has developed over the years, the retirement test represents a balancing of several inherently competing interests:

- to assure payment of benefits only to those who have truly retired;

- to allow beneficiaries to supplement their benefits with limited earnings;
- to reduce work disincentives; and
- to offer benefits that are as adequate as possible to those who most need them.

Considering the natural tension between these competing interests, it is no wonder that the retirement test is often the subject of debate.

Contract with America Proposal

The Contract with America includes a proposal to liberalize the Social Security retirement earnings test. Under this proposal, the annual exempt amount for beneficiaries attaining the normal retirement age (presently age 65) and through age 69 would be increased in stages beginning in 1996 to $30,000 in the year 2000. The exempt amount would be increased automatically thereafter based on the increase in average wages.

The short-range cost of the Contract proposal is estimated to be approximately $7 billion to the Social Security and Medicare Trust Funds over the first 5 fiscal years. The cost for the first 10 years would be approximately $15 billion.

SSA analysis shows that, by the year 2000, approximately 600,000 families would receive additional benefits under the Contract proposal. However, low-income families would receive little benefit from this modification to the retirement earnings test. This is because their earnings are already below the current law exempt amount or their earnings are so little above the exempt amount that they receive very limited gains from raising the exempt amount.

By the year 2000, families with incomes in 1996 dollars of less than $22,800 would receive only 2.2 percent of the total additional benefits, after taxes. In contrast, more than 47 percent of the total additional benefits would go to families with incomes of $55,800 or more. In fact, the upper 50 percent of earner families would receive 75 percent of the increase in benefits, after taxes. (See attachment for additional information on the distributional effects of the Contract proposal.)

Administration Views

The Administration recognizes that the earnings test can constrain the choices of employment and affect the standard of living for older beneficiaries who do not have other sources of income. Consequently, the Administration would support, in principle, a moderate increase in the retirement earnings test exempt amount for beneficiaries who have reached age 65. We believe that raising the exempt amount would be a sensible and practical approach to refining the balance among the competing program goals I mentioned earlier.

A moderate increase in the exempt amount would keep the short-range costs within reasonable limits, while helping to ensure that those beneficiaries who most need to do so have the opportunity to supplement their Social Security benefits with earnings. Further, a moderate increase in the exempt amount would direct more of the additional benefits toward low and middle earners, and not unduly advantage high earners.

Still, as I have indicated, Mr. Chairman, modifying the retirement test would have a short-range cost to the program. Although the Social Security Trust Funds have a surplus right now, program financing must be strengthened for the long range. Moreover, because Trust Fund surpluses are invested in Treasury securities, any reduction in the short-range surplus will increase the amount that the Treasury must borrow from the public. Therefore, we believe that any change in the retirement earnings test must be accompanied with offsetting changes which leave the financial balance unaffected.

Conclusion

In closing, Mr. Chairman, I would like to thank you again for the opportunity to discuss the Administration's views on the Social Security retirement test. We look forward to working with you and the other Members of Congress to determine how best to modify the retirement test, while also ensuring the financial well-being of the Social Security program.

ATTACHMENT

EFFECTS OF MODIFYING THE RETIREMENT EARNINGS TEST AS PROPOSED IN THE CONTRACT WITH AMERICA

The table below presents a simulation to raise the annual exempt amount (AEA) to $30,000 in 2000 for beneficiaries ages 65-69.

The table below shows the distribution in 2000 of aggregate net benefit increases 1/ by family income for earner families 2/ (column A) and percent paid to families with incomes above the upper limit of decile interval (column B).

	(A)	(B)
By Decile of Number of Families	**Distribution**	**Total Above Upper Limit**
TOTAL	100.0 %	
Income (1996 dollars)		
1: Less than $16,138	0.0 %	100.0 %
2: $16,138-$22,828	2.2	97.6
3: $22,828-$28,030	9.6	88.0
4: $28,030-$33,541	3.9	84.1
5: $33,541-$39,060	8.8	75.3
6: $39,060-$46,575	10.1	65.2
7: $46,575-$55,833	18.0	47.2
8: $55,833-$70,154	12.1	35.1
9: $70,154-$100,130	24.0	11.1
10: $100,130 or more	11.1	

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner families are families with at least one earner aged 65-69.

Source of Information: Social Security Administration, Office of Research and Statistics

SOCIAL SECURITY RETIREMENT EARNINGS TEST (RET)
FACT SHEET

- Under the retirement earnings test, the benefits payable to a retired worker, survivor, or dependent are withheld if he or she earns more than a specified amount (called an annual exempt amount). (An illustration of how the test works is attached.)

- In 1995:

  - The annual exempt amount is $8,160 for individuals under age 65. For every $2 earned over this limit, $1 is withheld from the benefits.

  - The annual exempt amount is $11,280 for individuals aged 65 to 69. For every $3 earned over this limit, $1 is withheld from their benefits.

- The annual exempt amount is increased each year based on increases in average wages. (SSA computes an average wage index which measures the increase in all wages in the economy from year to year. Wages generally rise faster than prices (as measured by the Consumer Price Index).)

- The retirement earnings test ceases to apply when a beneficiary reaches age 70, so that people who continue to work can still expect to receive a return on the Social Security taxes they have paid over their lifetimes.

- A special rule may apply in the first year of entitlement to benefits (the "grace" year):

  - A beneficiary may receive benefits for any month in which his or her earnings are under a monthly limit (one-twelfth of the annual exempt amount), regardless of his or her total earnings in that year.

  - The monthly limits for 1995 are $940 for beneficiaries aged 65-69, and $680 for beneficiaries under age 65.

  - The monthly limit ensures that a person who retires mid-year (after his or her earnings have exceeded the annual exempt amount) will begin receiving benefits when his or her earnings stop, rather than the following January.

  - For example, a worker who retires at age 65 at the end of July 1995, after having earned over $35,000 in 1995, would receive no benefits under the annual test.

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However, the "grace year" rule allows him or her to receive benefits for August 1995 through December 1995, assuming he or she does not exceed the monthly limit for those months. In 1996, the annual exempt amount would apply.

- Beneficiaries are asked to estimate their earnings for the year when they initially apply for benefits and to advise SSA if their estimates change. Benefits are withheld (in full monthly amounts beginning with January) based on this estimate.

  -- After the close of the year, beneficiaries are asked to report their actual earnings for the preceding year to SSA, and a final determination is made as to how much they should have received for that year. (Overpayments and underpayments result from this determination.)

  -- When beneficiaries report their actual earnings for the preceding year, they also estimate their earnings for the current year.

- Administration of the RET for the 65-69 age group (including recovery of overpayments) costs SSA about $100 million per year.

- If retirement benefits are withheld due to the RET (or if a worker delays filing beyond age 65), the benefit amount is increased under the delayed retirement credit (DRC) provision for each month between age 65 and 70 for which the worker does not receive a benefit.

  -- For workers reaching 65 in 1995, the DRC rate is 4 1/2 percent per year. If such a worker with a monthly benefit amount of $1,000 in 1995 had all 12 months of his or her benefits withheld for that year, the benefit amount will be 4 1/2 percent higher, or $1,045 per month, if he or she retired in January 1996.

  -- DRC rate will gradually increase to an actuarially fair level of 8 percent per year for workers reaching age 62 in 2005. At that point, any loss of benefits due to the RET will be offset by the benefit increase resulting from DRCs (for workers who reach the average life expectancy age).

Attachment

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Example Showing How the Retirement Earnings Test (RET) Applies to Beneficiaries Age 65-69

- For beneficiaries age 65-69 for whom the "grace year" provisions no longer apply, $1 in benefits is withheld for each $3 of earnings over the exempt amount ($11,280 in 1995).

- The following example illustrates the application of the annual earnings test for a worker age 65 in 1995:

  -- A worker earning $21,000 in 1995 and entitled to retirement benefits of $600 per month would have excess earnings of $9,720 ($21,000 minus the exempt amount of $11,280). The $9,720 is divided by 3 (under the $1 for $3 rule). The result, $3,240, represents the total amount of benefits that would not be payable for 1995.

  -- In the above example, monthly benefits of $600 would be withheld for January through May. A partial payment for June ($360) would be paid at the end of the year.

- Benefit deductions due to work are initially computed based upon an estimate of earnings for the year furnished by the worker. A final adjustment is made after the year when the worker reports the actual amount of his earnings to SSA.

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LEGISLATIVE HISTORY OF THE RETIREMENT EARNINGS TEST (RET)

ENACTMENT

1935	No benefits were payable for any month in which a beneficiary had any earnings in covered employment.
1939	Before any Social Security benefits were ever paid, the RET was modified. No benefits were payable for any month in which a beneficiary had covered earnings of $15 or more.
1950	Monthly exempt amount increased to $50. An annual test of $600 applied to newly covered self-employed workers. Beneficiaries age 75 and over exempted from the RET.
1954	Annual earnings test applied to employees as well as self-employed, with full benefits payable for any month in which earnings were below $80. The test now applied to noncovered earnings as well as covered earnings. Beneficiaries age 72 and over were exempted from the RET.
1960	The RET was revised to introduce the concept of reducing benefits by $1 for each $2 of earnings above the annual exempt amount.
1972	RET exempt amount automatically increased each year based on increases in average wage levels. (Previously, the exempt amount was raised on an *ad hoc* basis.)
1977	Established a higher exempt amount for beneficiaries age 65 and over than for those under age 65. The monthly earnings test was eliminated, except for the year of retirement.
1981	Beginning in 1983, beneficiaries age 70 and over were exempted from the RET.
1983	Beginning in 1990, the withholding rate under the RET for beneficiaries age 65 to 69 would be $1 of benefits for every $3 of earnings over the exempt amount.

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Estimated Changes in OASDI and HI Income and Outgo for Fiscal Years 1996-2000 Resulting From Raising the Annual Exempt Amount (AEA) Incrementally to $30,000 by the Year 2000 for Beneficiaries Ages 65-69

RAISE THE AEA TO $30,000 BY THE YEAR 2000 FOR BENEFICIARIES AGES 65-69	FISCAL YEAR (In billions)					TOTAL
	1996	1997	1998	1999	2000	1996-2000
a). Increase in OASDI benefit payments	$0.5	$1.1	$1.6	$2.1	$2.5	$7.7
b). Net reduction in OASDI administrative expenses	1/	1/	1/	1/	1/	.1
c). Increase in OASDHI revenues from taxation	1/	.1	.2	.2	.3	.8
d). Estimated offsets due to increased work activity 2/	3/	3/	3/	.1	.1	.2
e). Net total increase in OASDHI cost	.4	.9	1.4	1.8	2.1	6.6

1/ Net change is less than $50 million.

2/ Amounts shown reflect an increase in OASDHI payroll taxes and a reduction in Medicare Health Insurance benefit payments due to primary payment by private health insurance. The exact size of the induced work activity resulting from the elimination of the earnings test at ages 65-69 is uncertain. Actual amounts could be substantially different.

3/ Net increase in tax income plus net reduction in HI benefit payments of less than $50 million.

Note: Totals may not equal sum of components due to rounding.

Estimated Changes in OASDI and HI Income and Outgo for Fiscal Years 1996-2000 Resulting From Raising the Annual Exempt Amount (AEA) for Beneficiaries Ages 65-69 by $1,000 Over Present Law Amount in 1996 and Indexing Thereafter

RAISE THE AEA BY $1,000 IN 1996 FOR BENEFICIARIES AGES 65-69	FISCAL YEAR (In billions)					TOTAL
	1996	1997	1998	1999	2000	1996-2000
a). Increase in OASDI benefit payments	$.1	$.2	$.2	$.2	$.2	$1.0
b). Net reduction in OASDI administrative expenses	1/	1/	1/	1/	1/	1/
c). Increase in OASDHI revenues from taxation	1/	1/	1/	1/	1/	.1
d). Estimated offsets due to increased work activity 2/	3/	3/	3/	3/	3/	3/
e). Net total increase in OASDHI cost	.1	.2	.2	.2	.2	.9

1/ Net change is less than $50 million.

2/ Amounts shown reflect an increase in OASDHI payroll taxes and a reduction in Medicare Health Insurance benefit payments due to primary payment by private health insurance. The exact size of the induced work activity resulting from the elimination of the earnings test at ages 65-69 is uncertain. Actual amounts could be substantially different.

3/ Net increase in tax income plus net reduction in HI benefit payments of less than $50 million.

Note: Totals may not equal sum of components due to rounding.

Estimated Changes in OASDI and HI Income and Outgo for Fiscal Years 1996-2000 Resulting From Eliminating the Retirement Earnings Test (RET) in 1996 for Beneficiaries Ages 65-69

ELIMINATE THE RET FOR BENEFICIARIES AGES 65-69	FISCAL YEAR (In billions)					TOTAL
	1996	1997	1998	1999	2000	1996-2000
a). Increase in OASDI benefit payments	$3.9	$5.9	$6.0	$6.0	$6.1	$27.9
b). Net reduction in OASDI administrative expenses	1/	.1	.1	.1	.1	.3
c). Increase in OASDHI revenues from taxation	.5	.8	.8	.8	.8	3.8
d). Estimated offsets due to increased work activity 2/	.1	.2	.2	.2	.2	.7
e). Net total increase in OASDHI cost	3.2	4.8	4.9	5.0	5.0	23.0

1/ Net change is less than $50 million.

2/ Amounts shown reflect an increase in OASDHI payroll taxes and a reduction in Medicare Health Insurance benefit payments due to primary payment by private health insurance. The exact size of the induced work activity resulting from the elimination of the earnings test at ages 65-69 is uncertain. Actual amounts could be substantially different.

Note: Totals may not equal sum of components due to rounding.

EFFECTS OF INCREASING ANNUAL EXEMPT AMOUNT (AEA) OR ELIMINATING THE RET FOR BENEFICIARIES AGE 65-69

The table below shows the distribution in 1996 of aggregate net benefit increases 1/ by family income for earner families 2/:

1996 Family Income Less Than:	Proposals to Modify/Eliminate RET		
	Increase AEA by $1K, 1996	Raise AEA to $30K, 2000	Eliminate RET, 1996
	Distribution of Aggregate Net Increase:		
$22,800	7.9 %	2.2 %	0.9 %
$28,000	14.3	11.8	5.5
$33,500	19.7	15.7	7.9
$39,100	27.3	24.5	13.2
$46,600	36.4	34.6	21.6
$100,100	93.6	88.7	73.0

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner families are families with at least one earner age 65-69.

NET COST IMPACT

The table below shows net OASDHI costs after offset by additional income and payroll taxes, administrative savings, and reduction in Medicare costs:

	Increase AEA by $1K, 1996	Raise AEA to $30K, 2000	Eliminate RET, 1996
Net OASDHI Cost, FY 1996-2000	$0.9 billion	$6.6 billion	$23 billion

EFFECTS OF MODIFYING THE RETIREMENT EARNINGS TEST AS PROPOSED IN THE CONTRACT WITH AMERICA

The table below presents a simulation to raise the annual exempt amount (AEA) to $30,000 in 2000 for beneficiaries ages 65-69.

The table below shows the distribution in 2000 of aggregate net benefit increases 1/ by family income for earner families 2/ (column A) and percent paid to families with incomes above the upper limit of decile interval (column B).

	(A)	(B)
By Decile of Number of Families	**Distribution**	**Total Above Upper Limit**
TOTAL	100.0 %	
Income (1996 dollars)		
1:Less than $16,138	0.0 %	100.0 %
2:$16,138-$22,828	2.2	97.6
3:$22,828-$28,030	9.6	88.0
4:$28,030-$33,541	3.9	84.1
5:$33,541-$39,060	8.8	75.3
6:$39,060-$46,575	10.1	65.2
7:$46,575-$55,833	18.0	47.2
8:$55,833-$70,154	12.1	35.1
9:$70,154-$100,130	24.0	11.1
10:$100,130 or more	11.1	

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner families are families with at least one earner aged 65-69.

Source of Information: Social Security Administration, Office of Research and Statistics

EFFECTS OF INCREASING THE ANNUAL EXEMPT AMOUNT BY $1,000 IN 1996

The table below presents a simulation to raise the annual exempt amount (AEA) by $1,000 in 1996 for beneficiaries ages 65-69.

The table below shows the distribution in 1996 of aggregate net benefit increases 1/ by family income for earner families 2/ (column A) and percent paid to families with incomes above the upper limit of decile interval (column B).

	(A)	(B)
By Decile of Number of Families	**Distribution**	**Total Above Upper Limit**
TOTAL	100.0 %	
Income (1996 dollars)		
1:Less than $16,138	0.0 %	100.0 %
2:$16,138-$22,828	7.9	92.1
3:$22,828-$28,030	6.4	85.7
4:$28,030-$33,541	5.4	80.3
5:$33,541-$39,060	7.5	72.8
6:$39,060-$46,575	9.1	63.7
7:$46,575-$55,833	13.6	50.1
8:$55,833-$70,154	11.4	38.7
9:$70,154-$100,130	32.3	6.4
10:$100,130 or more	6.4	

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner families are families with at least one earner aged 65-69.

Source of Information: Social Security Administration, Office of Research and Statistics

EFFECTS OF ELIMINATING THE RETIREMENT EARNINGS TEST

The table below presents a simulation to eliminate the retirement earnings test in 1996 for beneficiaries ages 65-69.

The table below shows the distribution in 1996 of aggregate net benefit increases 1/ by family income for earner families 2/ (column A) and percent paid to families with incomes above the upper limit of decile interval (column B).

	(A)	(B)
By Decile of Number of Families	**Distribution**	**Total Above Upper Limit**
TOTAL	100.0 %	
Income (1996 dollars)		
1:Less than $16,138	0.0 %	100.0 %
2:$16,138-$22,828	0.9	99.1
3:$22,828-$28,030	4.6	94.5
4:$28,030-$33,541	2.4	92.1
5:$33,541-$39,060	5.3	86.8
6:$39,060-$46,575	8.4	78.4
7:$46,575-$55,833	11.6	66.8
8:$55,833-$70,154	14.3	52.5
9:$70,154-$100,130	25.5	27.0
10:$100,130 or more	27.0	

1/ Aggregate net benefit increase is the total increase in Social Security benefits paid minus the aggregate increase in Federal personal income taxes that the beneficiary must pay as a result of the additional benefit payments.

2/ Earner families are families with at least one earner aged 65-69.

Source of Information: Social Security Administration, Office of Research and Statistics

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Distributional Effects of Modifying the Retirement Earnings Test

The accompanying tables present simulations of several plans to modify the Social Security retirement earnings test (RET) for people above age 65.

Under current law, social security benefits for workers aged 65 through 69 are reduced at a rate of $1 for every $3 of earnings above the annual exempt amount (AEA). The proposals considered here would either increase the exempt amount or eliminate the test entirely. (The retirement test for younger workers, those aged 62 through 64, would be unaffected under all these proposals.)

The following proposals are simulated:

I. Complete elimination in 1996 of the retirement earnings test for workers above age 65.

II. Complete elimination in 2000 of the retirement earnings test for workers above age 65.

III. An increase in the year 2000 of the 65-69 AEA to $30,000. This corresponds to the fully-phased-in proposal in the Republican Contract With America.

The proposals are simulated with a microsimulation model using the March 1993 Current Population Survey (CPS) projected forward to represent 1996 and 2000.

Summary of results

- The effects of RET modifications are limited to families with beneficiaries aged 65-69 at the end of the year who have earnings in excess of the current-law exempt amount. Although the simulation estimates that there will be about 9.8 million families with persons aged 65-69 in 1996, only about 2.5 million of these families have earners aged 65-69. The numbers in 2000 will be slightly smaller: 9.5 million families with persons aged 65-69, of which 2.4 million have earners aged 65-69. In both years only about 26 percent of families with persons aged 65-69 have earners aged 65-69.

- In most of the 26 percent families with earners aged 65-69, the earners have earnings below the exempt amount. The effects of RET elimination are limited to the much smaller group of families with beneficiaries who have earnings above the exempt amount. Only about 740,000 families in 1996 (about 720,000 in 2000) fall into this group. This is about 29 percent of families with earners aged 65-69, and 8 percent of all families with persons aged 65-69, in both 1996 and 2000. (The 740,000 estimate includes a portion of earners who are not receiving benefits under current law but who would file for benefits if the RET were eliminated. No estimate is made, however, of the number of nonworking beneficiaries who might return to work if the RET were eliminated.)

- The number affected by increasing the AEA to $30,000 in 2000, rather than eliminating it entirely, is still smaller, about 600,000, rather than 720,000. This is about 24 percent of 65-69 earner families, and 6 percent of all families with persons aged 65-69.

- The percentage of families affected by RET elimination is correlated with income. No families in the bottom decile are affected, either in 1996 or 2000. In contrast, more than 40 percent of families in the top four earner-family deciles benefit from the proposal to eliminate the RET.

- The increase in benefits paid under RET elimination is also correlated with income. The bottom twenty percent of 1996 earner families (those with 1996 incomes less than $22,800) receive only 1.0 percent of the aggregate net increase under the plan to eliminate the RET. The bottom twenty percent of 2000 earner families (those with 2000 incomes less than $27,100) would receive only 0.9 percent of the net increase under complete elimination. The upper 50 percent of earner families, in contrast, would receive 87 percent of the net benefit increase from eliminating the RET (both in 1996 and 2000).

- The plan to raise the AEA to $30,000 in 2000 would restrict benefit increases to the upper decile families somewhat, but these families would still receive the preponderant share of the aggregate benefit increase. The upper 50 percent of earner families would receive 75 percent of the aggregate increase in net benefits, rather than the 87 percent under complete elimination. The bottom twenty percent of earner families would receive 2.2 percent of the aggregate increase in net benefits, rather than the 1.0 percent under complete elimination.

- Widow/widower families (most of whom are widows) tend to be less likely than other types of aged families to be affected by RET modifications and tend to receive a smaller benefit increase when affected.

Background

Under current law, benefits are reduced for beneficiaries who have earnings above the annual exempt amount. The AEA is indexed to the average wage series. In 1994 the AEA for beneficiaries aged 65-69 at the end of the year is $11,160. In 1996, under the 1994 Trustees' report assumptions used for the simulations, the AEA will have a projected value of $12,640, and in 2000 the AEA will have a projected value of $13,680.

For beneficiaries aged 65-69, benefits are reduced $1 for each $3 of annual earnings above the AEA. (Younger beneficiaries have a more stringent retirement test, with benefits reduced by $1 for each $2 above a lower AEA.) Any earnings after reaching age 70 are exempt from the test.

If the AEA is increased, beneficiaries who are receiving partially reduced benefits will receive benefits higher by one third of the amount of the increase. In addition, some beneficiaries who have already applied for benefits but whose benefits are reduced to zero by the earnings test may start receiving some benefits, depending on how high their earnings are above the new AEA. Some beneficiaries who under current law would not bother applying for benefits, knowing that the benefits would be reduced under the earnings test, might be induced under a relaxed earnings test to apply for benefits, again depending on how high their earnings are above the new AEA.

The simulation analysis focuses on the distribution of the benefit change by family income. By the nature of the earnings test, aged workers with high earnings are much more likely to be affected by the test, and to benefit from a relaxation of the test, than workers with low earnings. Workers with earnings just above the AEA will be affected as much by a small increase in the AEA as by a larger increase or by a complete elimination. Workers with very high earnings, in contrast, are more likely to be affected by a larger increase in the AEA or by a complete elimination than by a small increase. The share of the aggregate benefit increase received by low-earner workers will therefore be larger for small increases in the AEA than for larger increases or for complete RET elimination.

High-income beneficiaries include a portion of their benefits in taxable income under the Federal personal income tax. Any increase in benefits for these taxpayers will also increase their income taxes. The "net benefit increases" described in the summary of results are equal to the increase in the benefit paid minus any resulting increase in the income tax.

The simulation incorporates assumptions about benefit acceptance that may not accurately reflect behavior in 1996 or 2000. In particular, both the DRC's and the taxation of benefits will have changed between the survey year, 1992, which is used as the base for the simulation, and the simulated years. The DRC in 1992 was 3.0 percent to 4.0 percent per year, depending on age. In 1996 it will be 5.0 percent per year, and in 2000 it will be 6.0 to 7.0 percent per year, depending on age. The benefit taxation thresholds, which are non-indexed, will have fallen in real value between 1992 and the simulation years, and many of the workers affected by changes in the retirement test will also be affected by the increased taxation of benefits that was enacted in 1993, raising the portion of benefits includable in taxable income for high income workers to 85 percent from 50 percent. The combination of a higher delayed retirement credit, lower real benefit taxation thresholds, and the increase in percent of benefits taxable may cause a higher proportion of eligible beneficiaries to postpone entitlement, even if the RET is eliminated, than is assumed in the simulation.

CONTRACT

Now It's Up to the Senate, as House Fulfills Pledge . . .

Preface: Congressional Reforms

Action completed.

The House spent 14 hours on the opening day of the 104th Congress making internal changes to its operations that were part of the preamble to the contract. Lawmakers passed a bill **(HR 1)** that would apply a number of workplace laws to Congress, including civil rights and labor laws, the Family and Medical Leave Act and the Occupational Safety and Health Act.

The House also passed a resolution **(H Res 6)** making a series of internal changes. The rules changes restricted terms for committee chairmen (3 terms) and the Speaker of the House (4 terms); eliminated the District of Columbia, Merchant Marine and Post Office committees; prohibited proxy voting in committee; cut committee staff by one-third; required a three-fifths vote to increase income tax rates; eliminated taxpayer funding of legislative service organizations; banned floor voting by delegates and commissioners; and did away with simultaneous referral of bills to more than one committee.

No further action was required on the internal reforms and they took effect immediately. The Senate passed the compliance bill (S 2) and Clinton signed it.

Balanced Budget/ Line-Item Veto

Balanced budget passed by House, defeated in Senate.
House and Senate passed differing versions of line-item veto legislation. Now awaiting conference.

The House moved quickly to pass the two core fiscal reforms contained in the House Republican "Contract with America," a balanced budget amendment and a line-item veto for president. But the Senate rejected the amendment and rewrote the veto power measure.

The House passed a proposed constitutional amendment **(H J Res 1)** that would require a balanced federal budget, only to see the measure defeated in the Senate, 65-35.

Both chambers passed very different versions of the other key fiscal tool in the contract, the functional equivalent of the line-item veto for the president.

The House passed an "enhanced rescissions" bill **(HR 2)**. It would allow a president to propose cuts in part of a spending bill, or a narrowly targeted tax provision. If Congress did not act to overturn the president, the cuts would automatically go into effect. The president could veto a resolution of disapproval and Congress would have to muster a two-thirds vote to override.

Under the Senate-passed version, appropriations bills or measures that contain special interest tax breaks or new entitlement spending would be broken apart, after passage, into hundreds or thousands of new bills, each consisting of a separate item. These "separately enrolled" bills would then be subject to a presidential veto that could be overturned only by a two-thirds vote of both chambers of Congress.

Crime

House passed six bills, one bill pending.
No action in Senate.

House Republicans split their original, omnibus anticrime bill into seven smaller pieces and passed six of them. The bills seek to correct what Republicans consider to be the deficiencies of the 1994 crime law.

HR 667 would increase federal aid for prison construction, provided that states adopt tough sentencing laws. **HR 728** would combine last year's grants for police hiring and crime prevention into a block grant program that would give localities more choice in how they spend the money. **HR 668** would strengthen procedures to speed the deportation of aliens who commit serious crimes. Other bills would address issues that were not included in the 1994 law, such as limiting death row appeals **(HR 729)**, allowing federal prosecutors to use improperly obtained evidence if police officers acted in "good faith" **(HR 666)**, and requiring restitution for victims of federal crimes **(HR 665)**.

The seventh piece of the GOP crime package — to impose federal mandatory minimum sentences for carrying or using a gun during a serious crime — was postponed until later this spring.

In the Senate, the Judiciary panel is expected to begin considering similar legislation by the early summer.

Welfare

House action completed.
No action in Senate.

The House passed a bill **(HR 4)** to overturn 60 years of federally controlled anti-poverty programs. The bill would replace 44 federal programs with five block grants, giving states unprecedented authority over cash welfare; child welfare programs such as foster care; child care; school meals; and special nutrition programs for pregnant women and young children. The programs' entitlement status would end and eligibility for certain benefits would be curtailed. For example, mothers already on welfare could not receive additional payments for newborn children.

The House declined to create a block grant for food stamps, but it did limit spending.

The Senate Finance panel has held several hearings on welfare, but no markup has been scheduled and big changes in the House bill are likely.

Families and Children

House action completed.
Senate passed child bill, no ac on others.

The House approved several measures designed to strengthen families and encourage better treatment of senior citizens and children through tax incentives and stricter law enforcement.

The House passed legislation to authorize tax credits to families that adopt children or take care of elderly relatives as part of a broader tax cut bill **(HR 1215)**.

The welfare bill **(HR 4)** includes provisions to strengthen the enforcement of child support orders.

The House passed **HR 1240**, which would require tougher sentences for people convicted of sexually exploiting children through pornography or prostitution.

The House also approved a separate measure **(HR 1271)** that aims to protect the privacy of children and their families by requiring parental consent before minors could respond to surveys and questionnaires required by many federally funded programs.

. . . to Bring 'Contract With America' to a Vote

Middle-class Tax Cut

H action completed.
No action in Senate.

Included in the omnibus tax bill **(HR 1215)** are provisions to provide families a child tax credit, partially repeal the so-called marriage penalty and offer incentives for savings.The child tax credit, available to families earning as much as $200,000 annually, was by far the largest item in the bill, which would cost the Treasury an estimated $189 billion over five years and $630 billion over 10 years.

The bill also would reduce the tax liability for married couples who pay more filing jointly than they would if they filed as individuals. A third provision would create a new type of individual retirement account (IRA).

It was unclear how the package of tax breaks would fare in the Senate. Key Republican senators have expressed misgivings about clearing a large-

National Security

Ho passed, minus anti-missile defense language.
No action in Senate.

The House passed legislation **(HR 7)** to reorder the nation's defense priorities. The bill would reduce U.S. payments to the United Nations and ban U.S. troops from serving under a foreign command unless the president certified it was necessary to national security. During debate on the bill, Republicans narrowly lost, 218-212, a battle to keep in the bill strong language calling for deployment of an anti-missile defense as soon as practical.

The Senate Foreign Relations Committee has held hearings on the topic of national defense, but no action has taken place on the defense items in HR 7, and the Senate Armed Services Committee has no plans to take them up.

Senate Majority Leader Bob Dole, Kan., has introduced a bill **(S 5)** that would place limits on U.S. participation in United Nations' missions, but no action on that measure has been scheduled yet.

Social Security

House action completed.
No action in Senate.

As part of a larger tax bill **(HR 1215)**, the House approved a set of tax revisions and changes to Social Security designed to benefit senior citizens.

The provisions would allow seniors to earn more income without losing Social Security benefits and attempt to slow the rise in Medicaid costs in part by providing tax incentives for the purchase of long-term-care insurance. It would also repeal a 1993 law that raised taxes on wealthier Social Security recipients.

The package would raise the amount of annual income that senior citizens ages 65 to 69 can earn — from $11,160 to $30,000 over five years — before losing benefits. The tax bill faces an uncertain future in the Senate, where there is a strong sentiment among both parties to scale it back.

Capital Gains/ Regulations

House action completed.
Senate cleared unfunded mandates, paperwork reduction bills, no other floor action.

Paperwork reduction, costs of new government regulations, strengthening private property rights and regulatory process revisions all made up components of the plank designed to create jobs and boost wages.

One provision in the original bill (HR 9) — a reduction in the capital gains tax — was folded into the $189 billion tax-cut bill **(HR 1215)**.

Other parts of the catchall measure had to be splintered into separate bills to ease their legislative progress. The House passed: **HR 1022**, which would require proposed regulations to go through a series of cost-benefit and scientific tests; **HR 925**, which would compensate property owners for federal regulatory "takings" that reduced their property's value; **HR 5**, to reduce unfunded federal mandates; and **HR 830**, aimed at reducing the amount of paperwork the federal government requires.

Also passed separately was a measure **(HR 926)** requiring all agencies to do a cost-benefit analysis of any new regulations.

Civil Litigation/ Product Liability

Hc action completed.
Senate floor action on product liability set for April.

The House passed three measures that aim to curtail what many see as a nationwide "litigation explosion" by restricting a claimant's right to file suit and capping damages in certain cases.

The most far reaching of these bills **(HR 956)**, would rewrite product liability and medical malpractice law. The measure would cap punitive damages in all state and federal civil cases and non-economic damages, such as pain and suffering, in suits against health providers and insurers. Another bill **(HR 988)** would impose a modified "loser pays" rule in some federal cases designed to encourage parties to settle out of court. Finally, **HR 1058** would limit the right of disgruntled shareholders to sue corporations.

In the Senate, the proposals are less expansive. The Commerce Committee approved a product liability bill **(S 956)** that would cap punitive damages only in product liability cases. The Labor panel approved a medical malpractice measure **(S 454)** that does not include the House cap on non-economic damages.

Term Limits

Hc defeated.
No floor action in Senate.

This was the one contract promise that the House rejected. A proposed constitutional amendment **(H J Res 73)** to limit lawmakers to 12 years in office fell 61 votes short of the two-thirds majority required for a constitutional amendment.

Republicans supported the measure, 189-40, and leaders said voters would place the blame for defeat squarely on Democrats, who spurned the measure, 38-163. In fact, although most Republicans supported the measure, many senior Republicans also voted no.

The proposal also suffered from infighting among Republicans about whether states should be able to choose their own limit. Members also argued about how long a federally imposed limit should be.

On the Senate side, the Judiciary Committee on Feb. 9 approved a measure **(S J Res 21)** that would impose a 12-year limit on both chambers, despite the skepticism of its chairman, Orrin G. Hatch, R-Utah.

Description of Contract with America Proposal

Treatment of Beneficiaries Age 65-69

- Under the subject proposal, the annual exempt amount for beneficiaries attaining the normal retirement age (presently age 65) and through the month before the month of attainment of age 70 would be increased in stages during 1996-2000 to $30,000 in 2000. The exempt amount would be increased automatically thereafter based on the increase in average wages.

- The *ad hoc* increases in the exempt amount under the proposal are compared in the following table with the exempt amounts that are estimated to occur under the present-law indexing procedure. The projected present law amounts were determined using the alternative II assumptions of the 1994 Trustees Report, adjusted to reflect the actual 1995 exempt amount.

Calendar Year	Earnings Test Annual Exempt Amounts Under--	
	Present Law	Proposal
1995	$ 11,280	$ 11,280
1996	11,520	15,000
1997	12,120	19,000
1998	12,600	23,000
1999	13,080	27,000
2000	13,680	30,000

Treatment of Blind Beneficiaries

- The Contract with America proposal would not change the substantial gainful activity (SGA) threshold for blind disability beneficiaries from the amounts computed under present law. Under present law, the monthly earnings threshold used to determine SGA for blind disability beneficiaries is equal to 1/12 of the annual exempt amount for beneficiaries age 65-69. Under the Contract with America proposal, the blind SGA threshold amounts would continue to be based on the level of the exempt amounts that

SSA/OLCA
12/30/94

would have occurred under present law, rather than the *ad hoc* exempt amounts under the proposal.

- The following table provides the monthly SGA threshold amount for blind disability beneficiaries under present law and the proposal.

Calendar Year	Monthly SGA Threshold for Blind Disability Beneficiaries under Both Present Law and Proposal
1995	$ 940
1996	960
1997	1,010
1998	1,050
1999	1,090
2000	1,140

SSA/OLCA
12/30/94

GENERIC RESPONSE

What are your views on [any specific benefit or tax change in the Social Security program designed to address the long-range financing problem]?

- o We are willing to consider any proposal that would address the long-range financing difficulties in a manner that preserves the principles on which the Social Security program is based.

- o It would be premature to endorse ~~a~~ specific Social security reform proposals at this time.

  - -- The Advisory Council on Social Security is close to completing its work on recommendations for improving the long-range financial status of the OASDI program. Discussing and evaluating its recommendations will provide a springboard for public bipartisan debate on necessary changes to the Social Security program.

  - -- Advocating or dismissing individual options at this time would detract from creating the environment necessary for moving forward with meaningful bipartisan debate necessary for reform of the Social Security program.

- o We need to consider all proposals to address the long-range financing difficulties as part of a public bipartisan debate. Nevertheless, I can lay out some general points that should guide the debate and a number of criteria that I would use to judge any proposal.

  - -- The American people should be involved in recommending policy solutions in order to establish a public consensus concerning the program's future.

  - -- Changes should not be made in Social Security in order to reduce the general fund deficit. Rather, Social Security reforms should be designed to address long-term issues in the program.

  - -- Any changes should maintain and strengthen the defining characteristics of the program--its universality, its individual equity, and its social adequacy.

- o We will not be able to act effectively on the issues that must be confronted unless we develop a consensus among a well-informed public that decisive action is necessary. My priority has been, and continues to be, helping to develop an atmosphere that will lead us to that consensus.

What are your views on the provision in the Contract With America legislation to raise the retirement earnings test exempt amount and to repeal the increase in the taxation of benefits? What would be the impact of these changes on the trust funds?

- While the Administration does not support eliminating the retirement earnings test, the Administration would support, in principle, liberalizing the earnings test. We recognize that, for older beneficiaries who have no income other than Social Security, the earnings test can restrict their choice of employment and affect their standard of living.

- However, we are concerned about the budget impact of liberalizing the earnings test.

  - The earnings test proposal in the Contract With America is estimated to have a net cost of about $7 billion over the first 5 years. This cost would be largely offset by shifting to the OASDI trust funds the revenue from the taxation of benefits that would otherwise go to HI while the tax increase is being phased out.

- With respect to phasing out the recent increase in the amount of Social Security benefits subject to income tax, I regard this fundamentally as a tax policy matter and defer to the Secretary of the Treasury. However, I would point out that the provision to increase taxation of Social Security benefits and to dedicate the additional revenues to the HI trust fund was part of the President's fiscal year 1994 program to improve the financial health of the HI trust fund and that the tax increase affects only the wealthiest 10 percent of Social Security beneficiaries.

Additional Information

- The cost of liberalizing the earnings test depends on whether dynamic scoring is used, that is, whether or not cost offsets that occur due to induced work effort are considered. The following table shows the 5-year net cost of the earnings test proposal in the Contract with America legislation.

	With Dynamic Scoring	Without Dynamic Scoring
OASDI	$7.0 billion	$7.1 billion
OASDHI	6.6 billion	6.8 billion

- During the phaseout period, approximately $6.6 billion in revenue would be shifted from the HI trust fund to the OASDI trust funds. According to HCFA estimates, if the proposal became effective for January 1996, the depletion date for the HI trust fund would be advanced by an estimated 8 months. The current projected depletion date is 2002.

- Under present law, up to 50 percent of Social Security benefits must be included in taxable income for individuals with incomes from $25,000 through $34,000 and joint tax filers with incomes from $32,000 through $44,000. Up to 85 percent of Social Security benefits must be included in taxable income for the portion of income exceeding $34,000 for individuals, $44,000 for joint tax filers, and $0 for married individuals filing separately who lived with their spouses for at least part of the year.

SOLVENCY

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Report of Hearing
Before the
Committee on Finance
Subcommittee on Social Security and Family Policy

April 7, 1995

Subcommittee Members Present

Republicans : Simpson (Chairman, WY), Chafee (RI)

Democrats : Breaux (LA), Conrad (ND)

Purpose of Hearing

To hear testimony concerning the status of the Old Age and Survivors Insurance (OASI) and Disability Insurance (DI) trust funds.

Opening Statements

Chairman Simpson said that the recently released Report of the Social Security Board of Trustees shows that not one of the Social Security programs is solvent over the long range. He said

that, while the 1983 reforms to Social Security were to have made

the program solvent until 2083, the 1995 Trustees' Report projects that the OASI trust fund will be exhausted in 2031, the DI fund in 2016, and Medicare in 2002.

Witnesses and Their Testimony

Senator Robert Kerrey (D., NE), Dr. Shirley S. Chater, Commissioner of Social Security, accompanied by Harry Ballantyne,

Chief Actuary; and Stanford G. Ross and David M. Walker, Public Trustees of the Social Security and Medicare Trust Funds, appeared as a panel.

Senator Kerrey testified that Social Security's problems are not ideological but demographic, in that as the baby boom generation retires there will be fewer workers to support them. He recommended: take action to reform the Social Security program sooner and not later; make the Board of Trustees of the Social Security trust funds independent; and change Social Security trust fund investment policy to provide for private sector investment of trust fund assets, rather than making them available for Federal borrowing. He said that the nation as a whole must increase savings.

Commissioner Chater testified that income to the combined trust funds totaled $381.1 billion in 1994 and benefits and administrative expenses totaled $323 billion. Assets of the combined funds are expected to grow until 2020, and then decline until they would be exhausted in 2030, one year later than was projected in last year's report. She said that, in order for the program to be in balance over a 75-year period, the combined employer-employee OASDI tax rate, currently 12.4 percent, would have to be increased by 2.17 percent. She noted that no short term crisis exists, that there is time for thoughtful remedial action, and that the work currently being done by the Advisory Council on Social Security will be critical to reform. (A copy of the Commissioner's statement for the record is attached.)

Stanford G. Ross and David M. Walker issued a joint statement. Mr. Ross said that reforms to the OASI program should be undertaken without delay to ease the transition to providing financial stability in the next century. He testified that small changes made soon could make the program solvent, but cautioned that changes in the program to achieve deficit reduction would not be well-received by the public. Mr. Walker testified that, while Congress acted last year to restore short-term financial balance to the DI program, the reform was at the expense of the OASI program. He agreed that delay would increase the difficulty of reform and said that future retirees need information they can rely on to make plans for retirement. They both pointed out that the most critical issues relate to the Medicare program, which is unsustainable in its present form.

Senator Breaux asked whether including trust funds in calculation of the Federal deficit hurt the Social Security program. Commissioner Chater said that it undermines public confidence in the program. Mr. Walker said that many people invest in Treasury securities, and that those concerned about the safety of that form of investment are concerned about the future of government itself. He also noted that attention should be focused around 2013, when combined OASDI expenditures will exceed current tax income, rather than 2030, when the combined funds are exhausted. Mr. Ross said that, while they do not yield the highest rate of return, Treasury securities are virtually risk free.

In response to a question from Senator Chafee, Commissioner Chater said that many groups are spreading misinformation that adds to the public's fear about the future of Social Security. She said this could be countered with information such as the Trustees' Report Summary, and that she is trying to increase public confidence in the Social Security program by giving speeches whenever invited and promoting school programs.

In response to a question from Senator Conrad, Mr. Ballantyne said that, while he agreed that the Consumer Price Index (CPI) is probably overstated, he could not say to what degree.

Senator Breaux questioned whether a House-passed repeal of the provision imposing the income tax on up to 85 percent of Social Security benefits would hurt the Social Security system. Commissioner Chater said that the taxes involved were credited to the Hospital Insurance (HI) trust fund, and that she was concerned that repeal would cause the HI program to become exhausted 8 months earlier than 2002 AS NOW projected.

Mr. Walker said that the problems facing the HI program are so substantial that in perspective the repeal does not seem very significant. Mr. Ross said that in principle the revenue from the income tax should have been credited to the OASI trust fund. Senator Simpson agreed, and said that he was shocked that the House reduced the level of benefits potentially taxable to 50 percent from 85 percent.

Senator Simpson also noted that the CPI has huge cost effects, and asked what would happen to the trust funds if inflation increased to more than 10 percent a year. Mr. Ballantyne said that inflation that severe is not expected, and noted that, although double digit inflation would ultimately increase benefit payments, the immediate effect on the trust funds would be to increase income due to higher wages.

Attachment

FOR RELEASE ON DELIVERY

STATEMENT ON

STATUS OF THE OASDI TRUST FUNDS

BY

DR. SHIRLEY S. CHATER
COMMISSIONER OF
SOCIAL SECURITY

BEFORE THE
SENATE COMMITTEE ON FINANCE
SUBCOMMITTEE ON SOCIAL SECURITY
AND FAMILY POLICY

APRIL 7, 1995

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear here today to discuss the status of Social Security's Old Age and Survivors Insurance (OASI) and Disability Insurance (DI) trust funds.

I would like to focus first on the findings published in the 1995 Annual Report of the Board of Trustees, which was issued several days ago. I would then like to discuss steps we have taken, with the help of Congress, to address the short-term insolvency of the DI fund, and finally, I will also discuss the need to establish a climate of bipartisan consideration to ensure the long-term financial solvency of both the OASI and DI trust funds.

The 1995 Trustees Report

The Trustees' Report notes that, during calendar year 1994, OASDI benefits amounting to $316.8 billion were paid to retired and disabled workers and their families, and to survivors of deceased workers. At the end of last year, almost 43 million people were receiving OASDI benefits. In addition, almost 140 million people worked in jobs covered by the OASDI program and paid OASDI contributions on their earnings. Income to the combined trust funds totaled $381.1 billion in 1994, and expenditures--the amount paid in benefits and administrative expenses--totalled $323 billion. I am pleased that the $2.7 billion cost of administering the OASDI program in 1994 was less than 1 percent of benefits paid during the year.

The Trustees develop three alternative sets of estimates based on varying economic and demographic assumptions to show a range of possibilities regarding the financial conditions of the trust funds. Designated as alternatives I, II, and III, these estimates range from low cost (alternative I) to high cost (alternative III). Alternative II, the intermediate set of assumptions, reflects the Trustees' best estimate of what future experience will be. I would like to stress, however, that these projections are not certainties, but only estimates based on anticipated trends and occurrences. The projections take into account fertility rates, mortality rates, net immigration rates, productivity increases, labor force participation rates, unemployment rates, Consumer Price Index and other factors difficult to predict.

Under the 1995 Trustees' Report's intermediate assumptions, the assets of the combined OASI and DI trust funds are expected to grow until 2020, and then to decline until they would be exhausted in 2030, one year later than was projected in last year's Report. While in my testimony I will focus on the intermediate assumptions, it is worth noting that, even under the high-cost alternative III assumptions, the combined funds would be sufficient to pay benefits for more than 20 years.

The Trustees also project the status of the trust funds over the next 75 years--the period which is considered long range for program evaluation purposes. The OASI and DI programs, considered both separately and on a combined basis, are out of what the Trustees call close actuarial balance, for the period 1995-2069. Actuarial balance is essentially the difference between annual income and costs summarized over a given period. If the balance is negative, as it is now, the fund has an actuarial deficit.

The deficit is generally expressed in terms of a percentage of taxable payroll. The deficit in this year's Report for the OASDI program is 2.17 percent of taxable payroll, slightly larger than the difference of 2.13 in last year's report.

Reallocation of Tax Rate From OASI to DI

As you know, Mr. Chairman, the Social Security Domestic Employment Reform Act of 1994, which was enacted on October 22, 1994, changed the portion of the OASDI tax rate which is allocated to the DI fund for wages paid after December 31, 1993, and for self-employment income for taxable years beginning after that date. For 1994 through 1996, the rate allocated to the DI Trust Fund was increased from 0.6 percent to 0.94 percent for employers and employees each. This reallocation resulted in transfers of $14.2 billion from the OASI trust fund to the DI trust fund in October and November for the retroactive period. For 1997 through 1999, the DI rate increased from 0.60 percent to 0.85 percent, for employers and employees each, and beginning with the year 2000, from 0.71 to 0.90 percent.

With respect to last year's reallocation, I would like to note that, historically, reallocation of rates has been used on occasion to alleviate temporary funding problems encountered by the trust funds. The 1977 Amendments reallocated money from OASI to DI to help resolve temporary financing problems encountered by DI in the late 1970s. Conversely, funds were reallocated from DI to OASI in 1980 and 1983 to avoid depletion of the OASI Trust Fund. Had the funding for the DI program in the 1977 amendments been retained, the DI trust fund today would actually have an actuarial surplus over the next 75 years.

I want to point out, Mr. Chairman, that Congress has always been willing to protect the financial solvency of the trust funds by shifting income from one fund to the other as temporary solutions to financing problems, and I want to thank the members of this subcommittee for their help last year in ensuring that the DI fund can continue to pay benefits to disabled workers and their families, until 2016. While reallocation alone does not solve the problems facing the disability program, we now have time to carefully study the recommendations of the bipartisan Social Security Advisory Council, expected later this year.

Impact of Trends and the Trustees' Report

Mr. Chairman, as you requested in your letter of invitation to today's hearing, I would like to address the issue of past or future trends, and how we view their impact.

Every year the Trustees' Report takes a "snapshot" view of the status of the trust funds based on both positive and negative economic and demographic assumptions over a 75-year period. These assumptions take into account future trends that are supported by recent experience and future expectations, and, as I mentioned previously, represent estimates of what impact such trends will have on the Social Security program in both the short range and the long range. Of course, it is not possible to predict with certainty whether experience or expectations based on a few years represents a long-term trend or an unusual occurrence. Thus, the Report does not necessarily signal either the beginning of a trend or the continuation of one.

For instance, one of the most widely publicized trends in recent years is the growth in the number of people receiving disability benefits, which rose from 2.9 million in 1989 to 3.9 million in 1994. This growth represents an increase of 34 percent. However, while there are some indications that the growth in the program has slowed (applications and awards for disability benefits have remained about the same in 1993 and 1994), it is not appropriate to draw irrevocable conclusions for the long term based on this experience because the Trustees reevaluate these assumptions every year.

The 1994 Trustees' Report estimated that the combined OASI and DI trust funds would be exhausted in 2029. Because the 1993 Report had estimated that the trust funds would be exhausted in 2036--7 years later than the 1994 Report--there were concerns that the 1995 Trustees' Report would change the projected year of exhaustion to a still earlier year. This proved not to be the case, however, since the year of exhaustion improved slightly to 2030, one year later than last year's Report.

This change is primarily the result of recent economic and demographic experience which was more favorable than was assumed in last year's report. The economic experience included faster growth in the labor force, a lower unemployment rate, faster economic growth, faster growth in real wages, and slower growth in prices.

The demographic experience included revised intercensal estimates of the historical population and new postcensal estimates by the Bureau of the Census, which show fewer people at older ages than did earlier estimates. Other demographic changes include higher projected mortality rates, reflecting the latest data that show higher than expected mortality in 1992 and 1993.

Also, near-term birth rates were projected to be slightly higher based on recent experience.

A key change in the long-range intermediate assumptions is an increase in annual net immigration. The net number of immigrants assumed to enter the U. S. population each year was increased by 50,000, an increase consistent with estimates based on recent data from the Immigration and Naturalization Service.

While we need to be concerned about short-term trends such as the growth in the disability program, and understand the factors that underlie them, we should be careful to keep them in perspective. Our most important goal should be to ensure the long range solvency of the Social Security program. The value of the Trustees' Report is that it provides us with the best estimate of the program's long-range status.

Maintaining Financial Solvency

Clearly, the long-term financing issue that confronts Social Security requires careful consideration. Fortunately, we have the time we need to take measured and thoughtful action. In fact, the current Trustees' Report estimates reinforce the idea that we have time for thoughtful measured bipartisan Consideration. No short term crisis exists and we should avoid creating an atmosphere where potentially rash and hasty decisions might be made.

This is not to say that reforms should be delayed until a crisis occurs--they should not. Social Security is very important for everyone in the Nation. After careful deliberation, any adjustments necessary to strengthen the program should be made in a way that will allow time for individuals to make the necessary changes in their future retirement.

Mr. Chairman, history has shown us that successful efforts to reform the Social Security system are the fruit of careful evaluation, bipartisan concern, and discussion of the issues among the Congress, the Administration, and the public. To ensure there is sufficient funding of the Social Security program for all future generations, we should take a comprehensive, bipartisan approach to considering changes in the program.

The Advisory Council on Social Security is currently examining proposals for improving the Social Security program and the new Social Security Advisory Board will also be looking at these important issues. When I met with the Advisory Council, I emphasized the importance of their primary task, which is to focus on Social Security financing and to develop recommendations for improving the long-range financial status of the OASDI program.

It is impossible to overstate the importance of the work now being done by the Advisory Council. Reform of Social Security has generally not taken place without being preceded by recommendations from the Advisory Council on Social Security or a similar bipartisan panel. The Advisory Council is nearing completion of its work and I look forward to their findings and recommendations which we will review with the Congress.

Mr. Chairman, I strongly believe that changes in the Social Security program should be made solely to strengthen the program, not to meet short-term budgetary goals. It is unacceptable to make changes in Social Security in order to make a contribution to reduce the general fund deficit, including deficits in other entitlement programs. As a self-financed program, Social Security has always paid its own way. Any adjustments must be designed to ensure the adequacy of the program for future generations, not to achieve short-term budgetary goals.

Thank you again for the opportunity to discuss the status of the Social Security trust funds. I look forward to working with you to strengthen the program for future generations of American workers and their families.

SUMMARY OF THE 1995 TRUSTEES REPORT

- The OASI and DI Trust Funds, if combined, would be adequately financed over the next 10 years, and for many years thereafter. However, the OASDI program is not in close actuarial balance over the next 75 years, and the intermediate estimates indicate that the combined trust funds would be able to pay benefits timely for about the next 35 years.

- Individually, the OASI Trust Fund would have sufficient funds for the next 36 years under the intermediate assumptions, and the DI Trust Fund would have sufficient funds for the next 21 years.

- Based on the Trustees' intermediate estimates, income to the OASI and DI Trust Funds in calendar year 1995 will total $405.3 billion, and outgo will total $340.1 billion. The trust funds' reserves will increase in 1995 by $65.3 billion. The trust funds will have a cumulative reserve of $501.7 billion by the end of 1995. Shown separately (in billions):

	Income	Outgo	Net Increase	End of 1995
OASI	$347.4	$297.3	$50.0	$463.5
DI	$57.9	$42.7	$15.2	$38.1
Total	$405.3	$340.1	$65.3	$501.7

- The total reserves in the OASI and DI Trust Funds at the beginning of 1995 are about 1.3 times the estimated outgo in 1995; by 2011, the reserves are projected to rise to a maximum of about 2.7 times annual outgo and to decline steadily thereafter until the combined funds would be exhausted in 2030.

- Financial Events Under Intermediate Assumptions

	1995 Report	1994 Report
-- OASDI outgo exceeds tax income beginning:	2013	2013
-- OASDI outgo exceeds tax income plus interest income beginning:	2020	2019
-- OASI and DI Trust Funds exhausted:	2030	2029
-- OASI Trust Fund exhausted:	2031	2030
-- DI Trust Fund exhausted	2016	*1995
-- 75-year OASDI actuarial balance: (percentage of payroll)	-2.17	-2.13

* 2015, after reallocation

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Overview

I. CONCLUSION

The combined OASI and DI Trust Funds are adequately financed over the next 10 years, and for many years thereafter. At the beginning of 1995, the combined assets of the trust funds represented 128 percent of combined expenditures for 1995. The combined funds are projected to continue to grow during the next 10 years, and for many years thereafter, under both the intermediate and low cost assumptions. However, while the assets of the combined funds, in nominal dollars, continue to grow under the high cost assumptions for the next 10 years, 1995 through 2004, the trust fund ratio of assets to annual expenditures begins to decline in 2000.

The OASI Trust Fund is expected to grow rapidly during the next 10 years from a current level of 139 percent of annual outgo to about 2.5 times annual outgo by the year 2004, based on the intermediate assumptions. Thus, the OASI Trust Fund meets the criteria for financial adequacy in the short range by a wide margin.

The DI Trust Fund is also adequately financed over the next 10 years. Outgo from the DI Trust Fund exceeded income in both 1992 and 1993. However, these declines were reversed by the reallocation of part of the OASI contribution rate to DI that was enacted in 1994. The assets of the DI fund, in nominal dollars, are now expected to rise throughout the next 10 years, based on both the intermediate and low cost assumptions. The ratio of assets to expenditures is expected to increase from 54 percent at the beginning of 1995 to 142 percent by the beginning of 2003 and then to decline to 140 percent at the beginning of 2004, based on the intermediate assumptions.

Although the combined trust funds are well financed over the first 10 years and are expected to continue growing, in nominal dollars, for the first 25 years under the intermediate assumptions, the OASDI program is not in close actuarial balance over the next 75 years, based on these assumptions. The estimates indicate that the combined trust funds would be sufficient to enable the timely payment of benefits for the next 35 years. Relative to annual expenditures, the combined trust funds would continue to grow during the next 16 years, reaching a peak of about 2.7 times annual expenditures. Considering each fund separately, the OASI Trust Fund would have sufficient funds for the next 36 years, and the DI Trust Fund would be sufficient for the next 21 years. On the basis of the high cost assumptions, the combined funds would be sufficient to enable timely payment of benefits for about the next 21 years. Based on the low cost assumptions, the combined funds would continue to grow throughout the next 75 years, and they would be sufficient to enable timely payment of benefits during all of the long-range period.

For each of the next 18 years, OASDI income from payroll taxes and income taxes on benefits is expected to exceed total expenditures based on the intermediate assumptions. Starting about 14 years from now, however, OASDI costs as a percentage of taxable payroll are projected to begin increasing rapidly as the "baby-boom" generation reaches retirement age. In contrast, the program's income from payroll taxes and income taxes on benefits will represent a relatively level percentage of taxable payroll.

Therefore, under the intermediate assumptions, the OASDI cost rate is projected to exceed the income rate from 2013 through the end of the projection period, with the shortfall reaching 5.66 percent of taxable payroll by 2069, the end of the 75-year projection period. Based on the less favorable conditions assumed for the high cost estimates, the crossover point would be reached in about 1999, and the shortfall would grow eventually to 14.55 percent of payroll by 2069. With more favorable conditions, such as the low cost assumptions, the cost rate would exceed the income rate in 2021 and later, and the deficit would be 0.06 percent of payroll in the last year of the 75-year period.

Although, under the intermediate assumptions, the OASDI annual balances become negative after the first 18 years, the availability of interest earnings, in addition to tax revenues, results in projected trust fund growth (in dollars) that would continue for another 7 years. Because expenditures are estimated to increase at a faster rate than assets, however, OASDI assets would decline relative to annual disbursements, from about 2.7 times to about 2.0 times annual expenditures, during the same time period.

The actuarial balance of the OASDI program as a whole over the next 75 years is a deficit of 2.17 percent of taxable payroll, based on the intermediate assumptions. The deficit represents about 14 percent of the estimated cost rate over the next 75 years, and is therefore larger than the maximum 5-percent level allowed over that period by the test for close actuarial balance. Furthermore, beginning with the 1995-2028 period, and for all successively longer periods through the full 75-year period, the actuarial balances are deficits that are larger than the maximum levels allowed for close actuarial balance. Thus, the OASDI program is not in close actuarial balance.

Each trust fund, separately, is also out of close actuarial balance. On the basis of the intermediate assumptions, the OASI Trust Fund has an actuarial deficit of 1.87 percent of taxable payroll for the full 75-year valuation period, representing 14 percent of the OASI long-range cost rate. Similarly, the DI Trust Fund's actuarial deficit of 0.31 percent of taxable payroll represents 14 percent of the DI cost rate.

In view of the lack of close actuarial balance in the OASDI program over the next 75 years, the Board believes that the long-range deficits of both the OASI and DI Trust Funds should be addressed. The Advisory Council on Social Security is conducting an extensive review of Social Security financing issues, and the Board looks forward to receiving the Council's recommendations for restoring the long-range actuarial balance of the OASDI program.

MEANS TEST

6

Could you share with us your views on means-testing Social Security benefits?

- On numerous occasions, I have made it clear that means testing would violate one of the fundamental principles upon which Social Security is based -- that people who work and pay Social Security taxes will receive the benefits the program provides.

- By abandoning this principle, Social Security would be changed from social insurance to social welfare.

- Such a change would inevitably erode the strong public support that the program has enjoyed since its inception some 60 years ago.

    - This support is based on the concept that the Social Security taxes that workers pay establish an earned right to benefits that, unlike public assistance programs, is not dependent on a showing of financial need.

- Further, establishing a means test would discourage workers from building on their Social Security protection through private insurance, savings, pensions, and investments, because the income obtained from these sources could result in the loss of Social Security benefits.

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