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OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

Long-Term Financing of the Social Security Trust Funds (Decoupling)

SEPTEMBER 6, 1977

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Prepared by the staff of the Subcommittee on Social Security

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Long-Term Financing of the Social Security Trust Funds

Long-Term Financing—Decoupling

Amount of Deficit

Over the medium range (through year 2001), income to OASDI will be equal to 9.9 percent of payroll while the estimated outgo is 12.24 percent, leaving a deficit of about 2.34 percent. The estimated deficit is expected to increase to 7.67 percent for the period 2002–2026 and to 14.57 percent for the last 25 years of the 75-year valuation period. (See table 1.)

Over the 75-year period covered by the long-term actuarial cost estimates, the OASDI taxes provided under present law are estimated to provide income averaging 10.99 percent of taxable payroll while the benefits authorized are estimated to have an average cost of 19.19 percent of taxable payroll. The deficit is 8.20 percent of taxable payroll. The estimated annual deficit is expected to rise from about 1 percent of taxable payroll currently to over 15 percent at the end of the valuation period. As will be shown later, the various decoupling proposals would reduce the deficit in varying degrees.

The increases in program costs over the three 25-year periods are caused largely by (a) revisions in the long-range economic assumptions under which benefit levels are expected to rise faster and real wages slower than had been assumed earlier (the present benefit formula is extremely sensitive to both wage and price changes), (b) changing demographic patterns which sharply increase the ratio of aged to working age populations (as a result of low birth rates now and in the future in conjunction with the retirement of people born during the high-birth-rate period of the late 1940's and the 1950's) (see chart I), and (c) an expected continued rise in disability rates. (See table 2.)

Replacement Rates

A major factor contributing to the long-range deficit is the projected rise in social security benefit replacement rates—initial benefit levels as a percent of prior earnings—under current economic assumptions. Thus, a central question in developing a revised social security benefit structure is whether replacement rates should remain constant or decline over time. In addition, if replacement rates are to remain constant, consideration should be given to the level at which they should be fixed.

Current long-range projections show that benefit levels will rise by about 50 percent more than wages over the next 75 years, with most of this increase occurring after the 1990's. Under current economic assumptions, replacement rates are expected to rise significantly, particularly after the early 1990's. (See chart II.) Replacement rates can fluctuate widely in the future, either up or down, depending on future changes in wages and prices. (See chart III.)

It can be argued that Congress intended that replacement rates should remain constant at the levels established by the 1972 amendments which provided for automatically increasing benefits as the cost of living rises. It can also be argued that Congress did not endorse constant replacement rates at that time but merely wished to keep benefits up with increases in the cost of living. At that time it was expected, on the basis of the economic assumptions made then, that future replacement rates would remain fairly constant relative to wage levels. The rise in replacement rates under current assumptions causes roughly one-half of the long-term deficit.

The projected increase in replacement rates is due to the fact that benefits for people who will retire in the future will be affected by the changes in both wages and prices that occur during their working years. Their benefits will be affected by the automatic cost-of-living benefit increases, since such increases apply to future benefits for current workers as well as the benefits paid to current beneficiaries. A current worker's future benefits will also increase because his earnings are expected to increase as economic growth occurs.

Social security experts agree that the benefit structure should be "decoupled," that is, that current workers' future benefits be separated from those of beneficiaries currently on the rolls and that the automatic cost-of-living increases should apply only to those retirees on the rolls. Decoupling requires a new benefit formula for future beneficiaries that would produce replacement rates and costs that are much more predictable than under present law. Under all of the various decoupling proposals, the automatic CPI benefit increases after retirement would continue.

TABLE 1.—*Estimated expenditures under present law of old-age, survivors, and disability insurance system as percent of taxable payroll for selected years, 1977–2055*

[In percent]

Calendar year	Expenditures as percent of taxable payroll [1]			Tax rate in law	Difference
	Old-age and survivors insurance	Disability insurance	Total		
1977	9. 39	1. 50	10. 89	9. 90	−0. 99
1978	9. 38	1. 53	10. 91	9. 90	−1. 01
1979	9. 30	1. 55	10. 85	9. 90	−. 95
1980	9. 21	1. 59	10. 80	9. 90	−. 90
1981	9. 23	1. 65	10. 88	9. 90	−. 98
1982	9. 31	1. 71	11. 01	9. 90	−1. 11
1983	9. 40	1. 77	11. 17	9. 90	−1. 27
1984	9. 51	1. 84	11. 36	9. 90	−1. 46
1985	9. 64	1. 92	11. 56	9. 90	−1. 66
1986	9. 76	1. 99	11. 76	9. 90	−1. 86
1987	9. 86	2. 06	11. 92	9. 90	−2. 02
1988	9. 95	2. 13	12. 08	9. 90	−2. 18
1989	10. 03	2. 20	12. 23	9. 90	−2. 33
1990	10. 12	2. 27	12. 39	9. 90	−2. 49
1991	10. 20	2. 34	12. 54	9. 90	−2. 64
1992	10. 28	2. 41	12. 68	9. 90	−2. 78
1993	10. 35	2. 48	12. 83	9. 90	−2. 93
1994	10. 42	2. 56	12. 98	9. 90	−3. 08
1995	10. 50	2. 64	13. 14	9. 90	−3. 24
1996	10. 54	2. 73	13. 27	9. 90	−3. 37
1997	10. 60	2. 83	13. 43	9. 90	−3. 53
1998	10. 66	2. 92	13. 58	9. 90	−3. 68
1999	10. 72	3. 02	13. 74	9. 90	−3. 84
2000	10. 79	3. 12	13. 91	9. 90	−4. 01
2001	10. 89	3. 23	14. 12	9. 90	−4. 22
2005	11. 30	3. 66	14. 96	9. 90	−5. 06
2010	12. 46	4. 11	16. 57	9. 90	−6. 67
2015	14. 47	4. 42	18. 89	11. 90	−6. 99
2020	17. 05	4. 59	21. 64	11. 90	−9. 74
2025	19. 75	4. 55	24. 30	11. 90	−12. 40
2030	21. 57	4. 45	26. 02	11. 90	−14. 12
2035	22. 26	4. 43	26. 69	11. 90	−14. 79
2040	22. 12	4. 55	26. 67	11. 90	−14. 77
2045	21. 83	4. 76	26. 59	11. 90	−14. 69
2050	22. 02	4. 91	26. 93	11. 90	−15. 03
2055	22. 53	4. 98	27. 51	11. 90	−15. 61
25-yr averages:					
1977–2001	10. 00	2. 24	12. 24	9. 90	−2. 34
2002–26	14. 65	4. 20	18. 85	11. 18	−7. 67
2027–51	21. 86	4. 61	26. 47	11. 90	−14. 57
75-yr average, 1977–2051	15. 51	3. 68	19. 19	10. 99	−8. 20

[1] Expenditures and taxable payroll are calculated under the intermediate set of assumptions (alternative II) which incorporates ultimate annual increases of 5¾ percent in average wages in covered employment and 4 percent in CPI, an ultimate unemployment rate of 5 percent, and an ultimate total fertility rate of 2.1 children per woman. Taxable payroll is adjusted to take into account the lower contribution rates on self-employment income,on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

TABLE 2.—*Historical behavior and projections of replacement rates under present program*

- Initial average benefit same as in present law
- Workers earning records not indexed
- Benefit formula bend points not indexed
- Benefit formula factors CPI indexed (*ad hoc* increases prior to 1975)

[In percent]

	Worker with average earnings [1]		Replacement rate for worker with—		Aggregate OASD-expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings [2]	High earnings [3]	As percent of payroll	As percent of GNP [4]
Past years:						
1955	$2,141	31	45	31	3.3	1.3
1960	2,493	33	45	30	5.9	2.3
1965	2,665	32	43	33	8.0	2.8
1970	2,987	34	46	29	8.1	3.4
1975	3,619	43	56	30	10.7	4.6
Future years:						
1979	4,444	45	58	35	10.9	4.5
1985	5,354	48	60	35	11.6	4.8
1990	5,871	49	63	36	12.4	5.1
1995	6,476	49	66	37	13.1	5.4
2000	7,406	52	75	39	13.9	5.7
2010	9,489	56	84	42	16.6	6.8
2020	11,916	60	91	44	21.6	8.9
2030	14,765	63	96	46	26.0	10.7
2040	18,122	65	101	47	26.7	11.0
2050	22,088	67	106	48	26.9	11.1

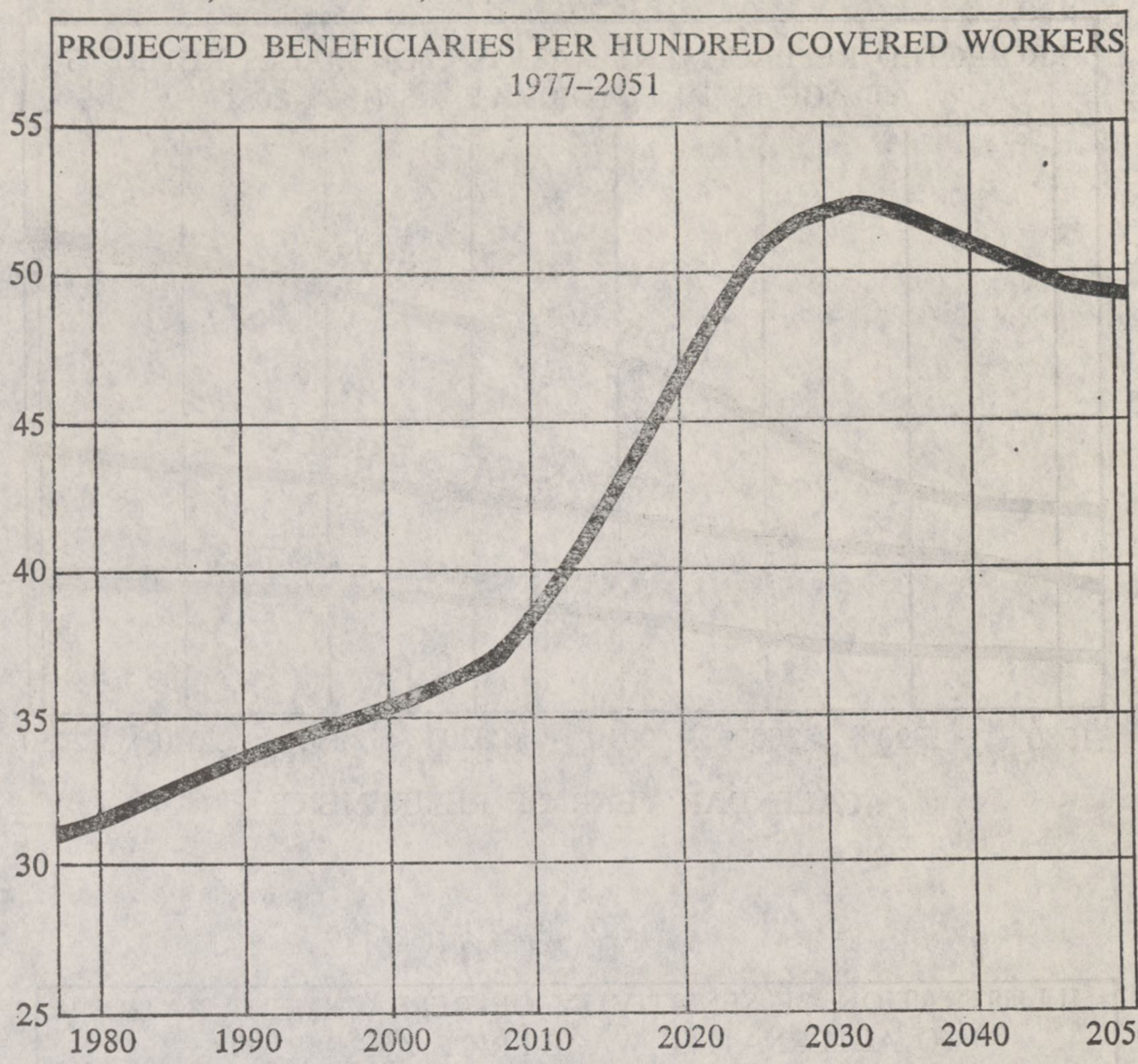
	Percent
Average medium-range cost (1977–2001)	12.2
Average medium-range revenue	9.9
Average medium-range deficit	−2.3
Average long-range cost (1977-2051)	19.2
Average long-range revenue	11.0
Average long-range deficit	−8.2

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.

NOTE.—The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative 11) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement.

CHART I

OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM



PROJECTED POPULATION, BENEFICIARIES, AND WORKERS IN COVERED EMPLOYMENT

Year	Projected Number (in millions)			Beneficiaries Per Hundred Covered Workers
	Total Population	OASDI Beneficiaries	Covered Workers	
1977	225.9	33.50	107.0	31.3
2000	264.6	47.76	135.4	35.3
2025	295.2	71.88	143.0	50.3
2050	311.5	74.48	150.9	49.4

OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM

CHART II

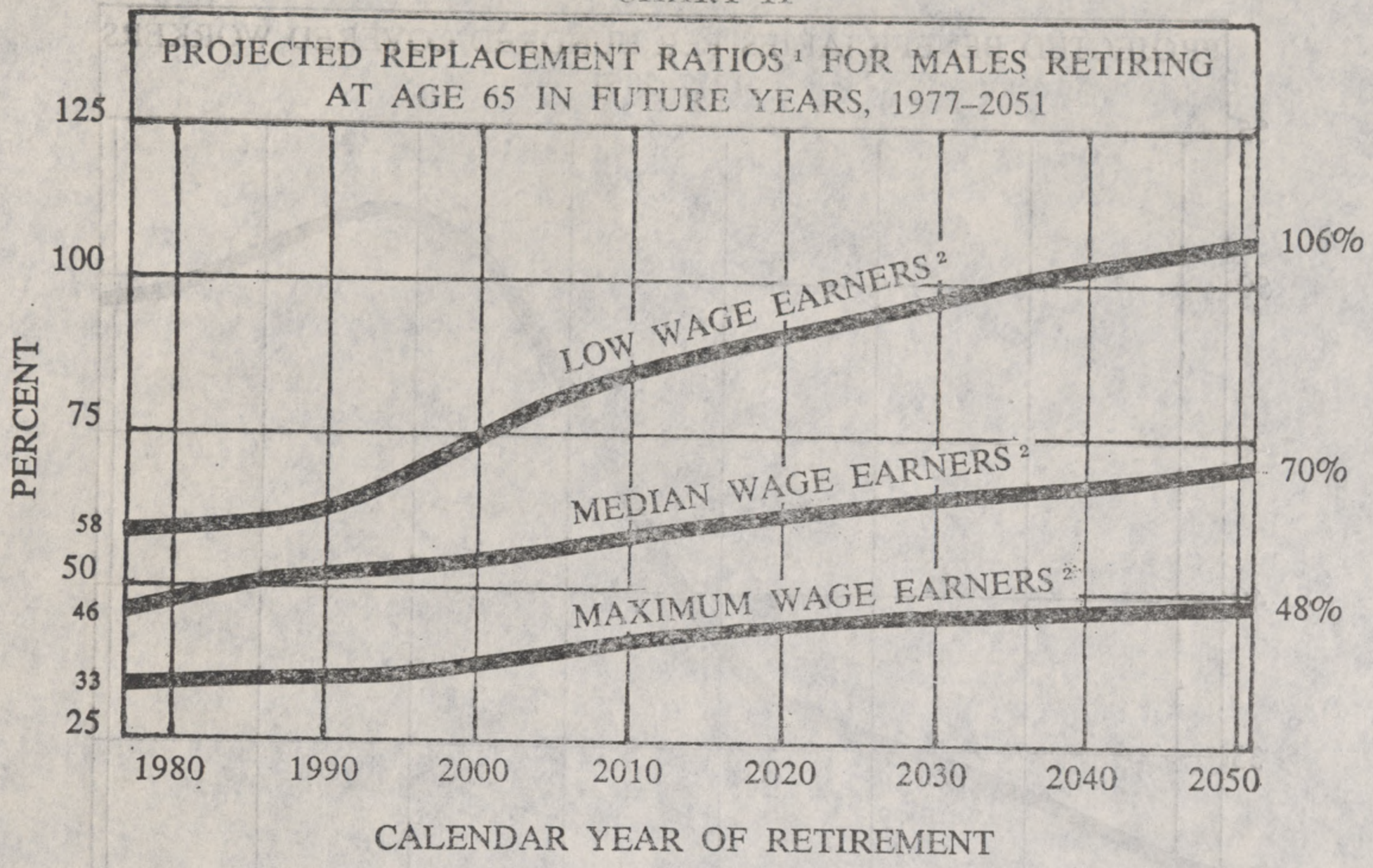
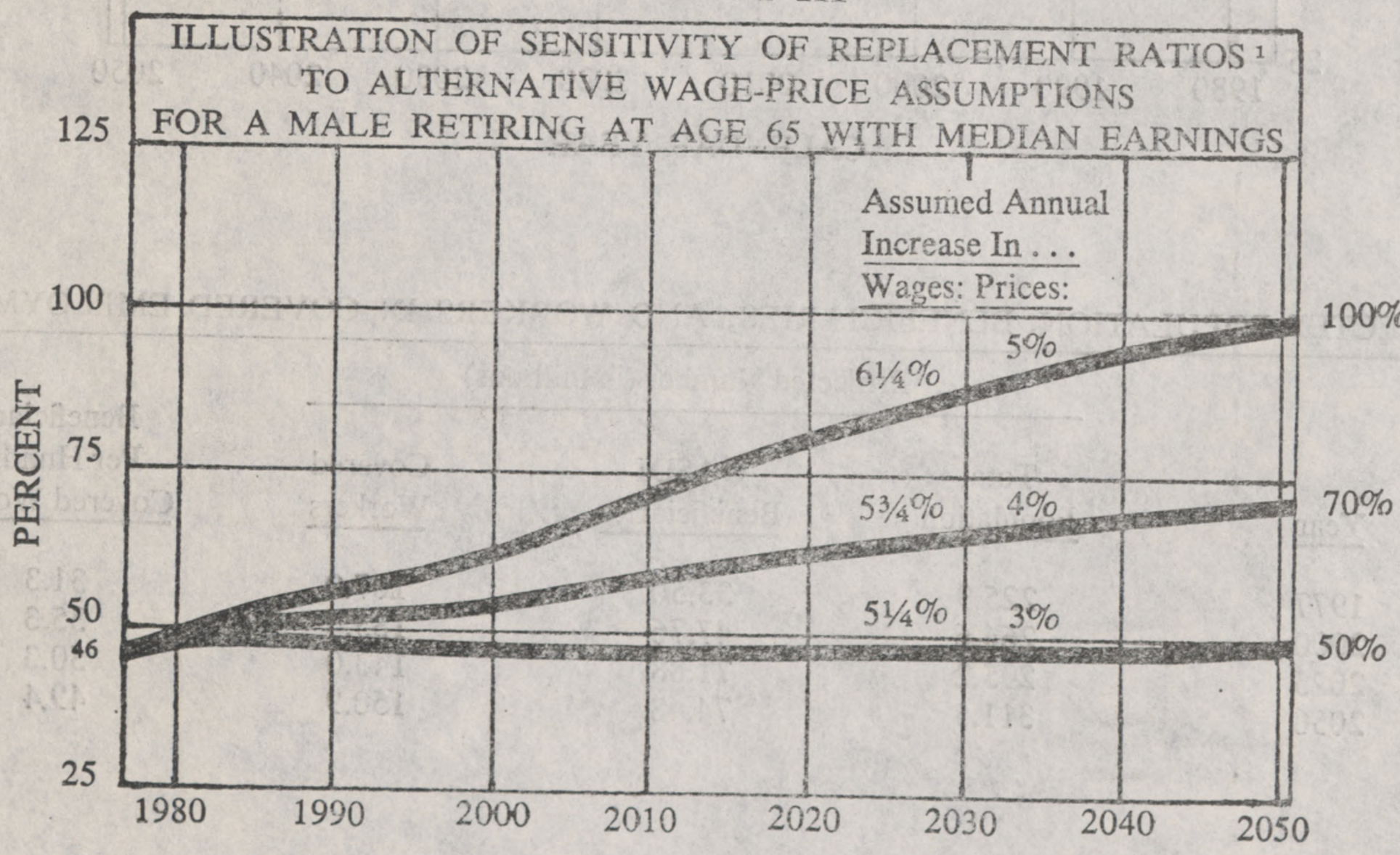


CHART III



[1] The Replacement Ratio is the ratio of the first year's benefits to the worker's earnings in his last year before retirement.

[2] In 1976, "low" earnings were $4,600: median earnings were $8,858 and "maximum" earnings were $15,300.

Decoupling Options

Three general approaches to decoupling have been proposed which would achieve different goals.

First—*the Administration approach*—is simply designed to correct the aberration of rising replacement rates that will occur under present law under virtually any reasonable assumptions as to future ware and price increases. This approach cuts the long-term costs of the program only to the extent that the flaw in the present benefit formula is expected to produce an unintended rise in replacement rates. Is does nothing to solve the long-term cost implications associated with a shift in the benefit/worker ratio.

Second—*the Myers approach*—would prevent replacement rates from rising and also reduce the rates to the level that existed prior to the benefit increases in 1972. In effect, this approach makes the judgment that the increase in replacement rates that began in 1972 is inappropriate.

Third—*the Hsiao panel and Senate Finance Committee staff approach*—attempts to deal with virtually all of the long-term deficit by providing for declining replacement rates in the future. The virtual elimination of the long-term deficit would be achieved by mixing the solution to the long-term financing problem with the need to correct a technical problem in the law.

Maintain Current Replacement Rates

This decoupling approach was recommended by the 1975 Advisory Council on Social Security and both the Ford and Carter Administrations. It is designed to make the system operate as it would have under the economic assumptions made when the automatic provisions were enacted in 1972; although the issue was little discussed at that time, it was assumed that replacement rates would have remained fairly constant in the future.

Under the Administration proposal (H.R. 8218), the benefit amounts payable to workers who retire in the future would generally reflect the increase in the standard of living that occurs during their working years (between age 20 and 64). Thus, while replacement rates would be stabilized, benefit amounts for each new group of retirees would rise in proportion to the general increase in wage levels.

A major feature of H.R. 8218 is that the worker's earnings would be indexed to reflect the change in general wage levels that has occurred during his working lifetime. These indexed earnings would be averaged (average indexed monthly earnings) and a three-step, weighted benefit formula [1] (designed to approximate benefit levels and replacement rates prevailing under present law when the new system is implemented) would be applied to his average indexed earnings to produce the worker's benefit amount. For those becoming entitled to benefits in the future, the benefit factors (percentage amounts) would not be indexed, but the bend points (dollar amounts) in the formula would be adjusted automatically as average wages increase.

By providing for the indexing of earnings and the benefit formula to the increase in general wage levels, benefits would be based on the worker's relative earnings position averaged over his working lifetime. As a result, all workers with the same relative earnings position would be treated the same regardless of when they become entitled to benefits. Thus, while the dollar amounts of benefits of, say, workers with average earnings retiring 20 or 30 years apart would be substantially different, their replacement rates would be the same.

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[1] The formula follows:
94 percent of the first $180 of AIME, plus
34 percent of AIME over $180 through AIME of $1,075, plus
16 percent of AIME above $1,075.

TABLE 3.—*Current replacement rates through wage indexing*

(Proposal recommended by Carter Administration)

- Initial average benefit close to present law in 1979
- Workers earnings records wage indexed
- Benefit formula bend points wage indexed
- Benefit formula factors not indexed

[In percent]

	Worker with average earnings [1]		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings [2]	High earnings [3]	As percent of payroll	As percent of GNP [4]
Year:						
1979	[5] $4,444	[5] 46	[5] 58	[5] 35	10.9	4.5
1985	5,027	45	58	34	11.5	4.7
1990	5,460	45	58	34	12.0	4.9
1995	5,939	45	58	35	12.4	5.1
2000	6,455	45	58	35	12.7	5.2
2010	7,626	45	58	36	14.0	5.7
2020	9,012	45	58	36	17.0	7.0
2030	10,648	45	58	36	19.3	7.9
2040	12,583	45	58	36	18.8	7.7
2050	14,868	45	58	36	18.1	7.5

	Percent
Average medium-range cost (1977–2001)	11.8
Average medium-range revenue (present law)	9.9
Average medium-range deficit	—1.9
Average long-range cost (1977–2051)	15.3
Average long-range revenue (present law)	11.0
Average long-range deficit	—4.3

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.
[5] The present law benefit formula applies for all workers attaining age 62 before Jan. 1, 1979.

NOTE.—The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative 11) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady immediately prior to retirement. The values in this table refer only to the Administration wage-indexing proposal with the transitional provision and exclude the effect of all other benefit and financing modifications in the Administration proposal.

This decoupling option would have a significant impact on the long-range cost of the social security program. Under current economic and demographic assumptions, this approach would reduce the current long-range financial deficit of the social security cash benefits program by about half—from an average of 8.2 percent of payroll over the next 75 years to an average of about 4.3 percent of payroll.

Thus, that portion of the long-term deficit that can be attributed to the rising replacement rate aberration under present law would be eliminated. This approach, then, does not attempt to change the basic nature of the system. The remaining 4.3 percent deficit is largely due to the changing age composition resulting from the baby boom of the 1940's and 1950's combined with the lower fertility rate expected in the future, and the adverse experience in the disability program.

If the Administration's benefit and financing proposals are taken into account, there would be a surplus of 0.5 percent of taxable payroll over the medium range and the 75-year deficit would be reduced from 4.3 percent to 2.1 percent of taxable payroll. These proposals include four $600 earnings base increases for employees, elimination of the base for employers (in three steps),

rescheduling the tax rate increase now scheduled for 2011 to 1985 and 1990 for employers and employees, reallocation of taxes from the HI program, increasing the self-employment tax rate to three-quarters the combined employee-employer rate, and a dependency test for spouses benefits.

If this alternative were adopted, the Congress would have to deal with all or part of the remaining deficit by providing additional increases in social security tax contributions, adding general revenue contributions, or changes in the social security benefit structure or eligibility requirements or combinations of these approaches.

Maintain Lower Replacement Rates

A variant—wage indexing at lower than prevailing benefit levels—which would result in constant but lower replacement rates and reduce the long-range deficit by more than one-half has been recommended by the Chamber of Commerce, the American Council of Life Insurance, and the National Association of Manufacturers. It was designed by the former Chief Actuary of the Social Security Administration, Robert J. Myers.

As under the Carter Administration proposal, all workers retiring in the future would share in the rise in real wages and in the standard of living that occurs during their working lifetime. The primary difference between the proposals is that replacement rates would be stabilized at a lower level, about 11 percent below existing law. (Both proposals would wage index the worker's earnings and the bend points in the benefit formula.)

TABLE 4.—*Replacement rates through wage indexing at reduced replacement rate level*

(Proposal recommended by Robert J. Myers)

- Initial average benefit close to 11 percent below present law in 1979
- Workers earnings records wage indexed
- Benefit formula bend points wage indexed
- Benefit formula factors not indexed

[In percent]

	Worker with average earnings [1]		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings [2]	High earnings [3]	As percent of payroll	As percent of GNP [4]
Year:						
1979	[5] $4,444	[5] 46	[5] 58	[5] 35	10.9	4.5
1985	4,481	40	52	28	11.1	4.6
1990	4,868	40	52	28	11.2	4.6
1995	5,293	40	52	29	11.2	4.6
2000	5,752	40	52	29	11.3	4.6
2010	6,797	40	52	30	12.3	5.1
2020	8,032	40	52	30	14.9	6.1
2030	9,492	40	52	30	16.9	7.0
2040	11,215	40	52	30	16.4	6.8
2050	13,252	40	52	30	15.9	6.5

	Percent
Average medium-range cost (1977–2001)	11.1
Average medium-range revenue (present law)	9.9
Average medium-range deficit	−1.2
Average long-rage cost (1977–2051)	13.7
Average long-range revenue (present law)	11.0
Average long-range deficit	−2.7

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.
[5] Assumed to be based on the present new benefit formula for all workers attaining age 62 before Jan. 1, 1979 (as in H.R. 8218).

NOTE.—The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative II) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement. The values in this table refer only to the Myers wage-indexing proposal with the transitional provision and exclude the effect of any other benefit and financing modifications.

This proposal suggests that the rise in replacement rates resulting from the 1972 legislation and the subsequent automatic benefit increases is unwarranted. And it would somewhat reduce the relative role of social security as a retirement program and place greater reliance on private pensions, personal savings, private insurance and means-tested public assistance in meeting the retirement income needs of the aged.

Since replacement rates would be lowered, this approach would eliminate the costs of rising replacement rates in the future plus the costs arising from the effect of benefit increases since 1972 on replacement rates. The proposal would reduce the deficits to 1.1 percent over the medium range and to 2.7 percent over the 75-year valuation period.

In testimony before the Subcommittee, Mr. Myers suggested increasing the present law tax rate schedule, by 0.5 percent in 1978 and by an additional 0. 25 percent in 1985 for employers and employees, each, and increasing the self-employment tax rate as per the Administration. If these proposals were adopted, in conjunction with the dependency test included in the Administration bill, there will be a surplus of 0.3 percent of taxable payroll over the medium range and a deficit of 1.0 percent over the long range.

Declining Replacement Rates Based on Price Indexing

The Panel of Consultants to the Congressional Research Service (Hsiao panel) recommended a decoupling proposal under which replacement rates would decline rapidly until 1991 and gradually thereafter. Replacement rates for the average worker would decline to 26 percent (as compared with 45 percent under the Carter proposal and 40 percent under the Myers proposal) for workers retiring in the year 2050. The range of replacement rates between regularly employed low-wage earners and maximum earners would also be reduced. Currently, replacement rates range from 58 percent for low-wage earners to 35 percent for maximum earners. Under the price indexing proposal, these replacement rates would eventually range from 32 percent to 23 percent respectively.

This proposal would substantially reduce benefit amounts below what could be expected if replacement rates were maintained at current levels. For example the average earner who retires in 1990 would receive about $786 a month (45 percent of his prior earnings) under the Administration's proposal, and $662 a month (38 percent of prior earnings) under this proposal. This differential would gradually increase for average workers who retire after 1990. Thus, a worker's initial benefit upon retirement in the future would reflect only part of the increase in real wages and the increase in the standard of living that has occurred during his lifetime. It would reflect more than the increase in the cost of living, however. Initial benefits for workers who retire between now and 1991 would reflect only a small part of the real wage growth that occurs during the period. After 1991, the rate of decline in replacement rates is much slower, and a slowly growing proportion of real wage growth would be reflected in the initial benefit amount.

TABLE 5.—*Declining replacement rates through price indexing*

(Proposal recommended by panel of consultants to Congressional Research Service—Hsiao Panel)

- Initial average benefit close to present law in 1979
- Workers earnings records CPI indexed
- Benefit formula bend points CPI indexed
- Benefit formula factors not indexed

[In percent]

	Worker with average earnings [1]		Replacement rate for worker with—		Aggregate OASDI expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings [2]	High earnings [3]	As percent of payroll	As percent of GNP [4]
Year:						
1979	[5] $4,444	[5] 46	[5] 58	[5] 35	10.9	4.5
1985	4,508	41	53	30	11.0	4.5
1990	4,597	38	50	28	11.0	4.5
1995	4,713	36	47	28	10.8	4.4
2000	4,908	34	45	28	10.5	4.3
2010	5,360	32	42	27	10.6	4.3
2020	5,962	30	40	26	12.0	4.9
2030	6,665	28	37	25	12.8	5.3
2040	7,496	27	35	24	11.8	4.9
2050	8,477	26	32	23	10.9	4.5

	Percent
Average medium-range cost (1977–2001)	10.8
Average medium-range revenue (present law)	9.9
Average medium-range deficit	—.9
Average long-range cost (1977–2051)	11.3
Average long-range revenue (present law)	11.0
Average long-range deficit	—.3

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.
[5] Assumed to be based on the present law benefit formula for all workers attaining age 62 before Jan. 1, 1979 (as in H.R. 8218).

NOTE.—The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative 11) in the 1977 OASDI Trustees Report. The replacement rates pertain to workers with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement. The values in this table refer only to the Hsiao price indexing proposal with the transitional provision and exclude the effect of all other benefit and financing modifications.

Under current assumptions, enactment of this proposal would virtually eliminate the long-range deficit, although some additional revenues would still be needed. The deficits would be reduced to 0.9 percent of payroll over the medium range and to 0.3 percent over the long range. The Panel also suggested a wage base increase and tax rate adjustments that would reduce the deficits further.

In considering the cost-reduction effect of this proposal, it should be noted that one of the goals of the panel's proposal is to give Congress flexibility to adjust benefits from time to time through ad hoc action to restore replacement rates as economic and social conditions change. If replacement rates are restored in the future, additional financing may be required and the cost reduction resulting from this option would not be realized.

The panel's proposal implicitly assumes that if real wage growth occurs, workers will be able to afford to purchase private protection if they want to maintain the same standard of living in retirement as would be provided by social security under either proposal to maintain constant replacement rates. If workers fail to purchase private protection and Congress does not restore replacement rates, this alternative may result in shifting some part of the cost of income maintenance for the aged from social security to public assistance.

Although the proposed benefit formula would be less sensitive to changing economic conditions than present law, it would be more sensitive than either of the wage indexing proposals described previously because initial benefits would still be affected by both price and wage changes.

Combination Approach

A decoupled social security benefit structure can be designed so as to provide constant replacement rates for certain periods and declining replacement rates during other periods. The Senate Finance Committee staff developed one such decoupling approach under which replacement rates would be constant through 1987, decline during the 1988–2030 period, and remain constant thereafter. Although this approach is based on indexing both the worker's wages and the benefit formula to changes in average wages, the benefit percentage factors that apply to different ranges of average indexed monthly earnings in the formula would be reduced by one-half the increase in real wages each year during 1988–2030. This would cause replacement rates to decline during the period.

The decline in replacement rates occurs approximately at the same time that the ratio of beneficiaries to workers is increasing so it may be assumed that this pattern of replacement rates is intended both to correct the flaw in the present benefit structure and to offset nearly all of the cost effects due to projected demographic changes. The decline in replacement rates would reduce the medium-range deficit from 2.34 percent to 1.7 percent and the overall decline would reduce the long-range deficit from 8.2 percent to 1.6 percent.

The Senate Finance Committee staff also suggested increasing tax rates in 1981, eliminating the wage base for employers in 1978, offsetting benefits for dependents and survivors by the amount of any pension based on noncovered employment that is received from a public retirement system, reallocating taxes from the HI trust fund, increasing the wage base for employees and self-employed persons as in the administration bill, and increasing the self-employed tax rate (also in the administration bill). The overall effect of these changes would be to provide a 0.6 percent surplus over the next 25 years and a 0.2 percent surplus over the next 75 years.

TABLE 6.—*Combination alternative*

(Proposal recommended by Senate Finance Committee staff)

- Initial average benefit close to present law in 1978
- Workers earnings records wage indexed
- Benefit formula bend points wage indexed
- Benefit formula factors not indexed before 1988, then reduced by 50 percent of gains in real earnings until 2030, thereafter not indexed

[In percent]

	Worker with average earnings [1]		Replacement rate for worker with—		Aggregate OASD expenditures	
	Annual benefit in 1977 prices	Replacement rate	Low earnings [2]	High earnings [3]	As percent of payroll	As percent of GNP [4]
Years:						
1979	[5] $4,444	[5] 46	[5] 58	[5] 35	10.9	4.5
1985	4,949	45	57	34	11.5	4.7
1990	5,243	44	56	33	11.9	4.9
1995	5,466	42	54	32	12.0	4.9
2000	5,697	40	52	32	11.9	4.9
2010	6,191	37	47	30	12.1	5.0
2020	6,727	34	44	28	13.6	5.6
2030	7,311	31	40	25	14.3	5.9
2040	8,639	31	40	25	13.2	5.4
2050	10,208	31	40	25	12.6	5.2

	Percent
Average medium-range cost (1977–2001)	11.6
Average medium-range revenue (present law)	9.9
Average medium-range balance	−1.7
Average long-range cost (1977–2051)	12.6
Average long-range revenue (present law)	11.0
Average long-range balance	−1.6

[1] Assumed to be 4 times the average 1st quarter covered earnings.
[2] Assumed at $4,600 in 1976 and following the trends of the average.
[3] Assumed at the maximum taxable under the program.
[4] Based on full employment and assuming taxable payroll equals 41.1 percent of GNP.
[5] Assumed to be based on the present law benefit formula for all workers attaining age 62 before Jan. 1, 1979 (as in H.R. 8218).

NOTE.—The estimates in this table are based on the economic and demographic assumptions used in the intermediate cost estimates (alternative 11) in the 1977 OASDI Trustees Report. The replacement rates pertain to worker with steady employment at increasing earnings and compare the annual retirement benefit at age 65 with the earnings in the year immediately prior to retirement. The values in this table refer only to the combination alternative with the transitional provision and exclude the effect of all other benefit and financing modifications.

Only part of the real wage growth that occurs during the 1988–2030 period would be reflected in initial social security benefit amounts. As workers retire, become disabled, or die during the declining replacement rate period, they would have to rely on private pensions, other forms of private protection, or public assistance programs to meet an ever increasing proportion of their income needs. Thus, the projected increase in dependency costs of the aged resulting from the drop in fertility rates (number of children per woman of child-bearing age) would be met by reducing the benefits payable to future beneficiaries.

As a result, the cost of the social security program as a percentage of taxable payroll would be reduced considerably, which means that the revenues needed to support the program in the next century would be significantly lower than under present law, the Carter Administration proposal, or the proposal of the business community.

On the other hand, the decline in replacement rates would appear to be governed solely by cost considerations rather than by any judgment between appropriate and excessive replacement rates. In particular, the timing of this decline is subject to question. By maintaining constant replacement rates for 10 years before starting to reduce them, the proposal fails to deal with the difficult policy decision relating to proper replacement rates in a realistic and permanent manner.

Cost Effects and Replacement Rates Compared

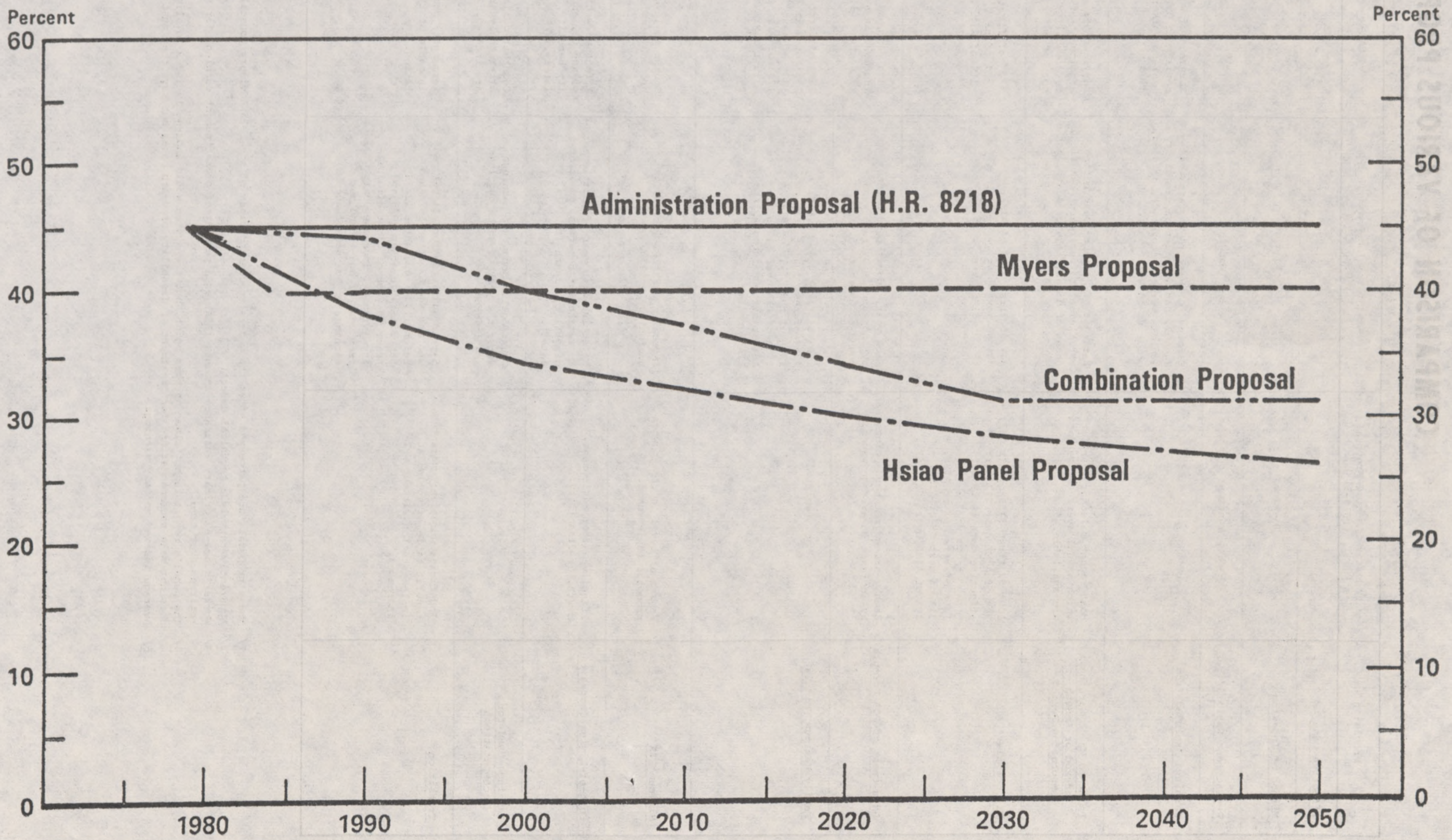
TABLE 7.—*Effect of alternative decoupling plans on average medium- and long-range deficits*

[In percent of taxable payroll]

	Present law	Carter Administration	Myers	Hsiao	Senate Finance Committee staff
Average medium-range (1977–2001):					
Cost	12.2	11.8	11.1	10.8	11.6
Revenue	9.9	9.9	9.9	9.9	9.9
Deficit	2.3	1.9	1.2	0.9	1.7
Average long-range (1977–2051):					
Cost	19.2	15.3	13.7	11.3	12.6
Revenue	11.0	11.0	11.0	11.0	11.0
Deficit	8.2	4.3	2.7	0.3	1.6

CHART IV

Comparison of Replacement Rates for Average Earner Under Various Decoupling Proposals



94-950—77——3

COMPARISON OF VARIOUS PROPOSALS FOR

Provision	Advisory Council Proposal (1974-5)	Administration Proposal 1/ (H.R. 8218)	NAM-Myers' Proposal 1/
Effective Date	Not specified	1979	1979
Method of Indexing	To wages	To wages	To wages
Replacement Ratio 3/	Constant	Constant	Constant
Earnings Excluded from Indexing	Not specified	Earnings of workers who attained age 62, had an onset of disability (unless worker recovered), or died, prior to 1979.	Earnings of workers entitled to retirement or disability benefits (unless worker recovered) or who died prior to 1979.
Point to Which Earnings Indexed or Length of Computation Period	Most recent calendar year for which annual average wage data are available.	Earliest of: Second year before entitlement to retirement benefits, onset of disability, or death, but not before 1977.	Earliest of: Second year before attainment of age 62, entitlement to disability benefits, or death, but not before 1977.
PIA Formula	100% of first $123 of AIME 5/, + 31% of AIME over $123 (if effective date is 1976.) -- or -- 100% of first $X of AIME, + 31% of next $Y of AIME, + 20% of AIME over ($X + $Y).	94% of first $180 of AIME, + 34% of next $895 of AIME, + 16% of AIME over $1075.	82% of first $190 of AIME, + 30% of next $760 of AIME, + 10% of AIME over $950
Adjustment of PIA Formula	Each year, adjust bend points 6/ by increase in average wages.	Each year, adjust bend points by increase in average wages; round to nearest $5.	Each year, adjust bend points by increase in average wages; round to nearest $1.
Family Maximum Formula	Not specified	150% of first $245 of PIA, + 275% of next $95 of PIA, + 130% of next $115 of PIA, + 175% of PIA over $455. Adjust maximum formula like PIA formula.	150% of first $249 of PIA, + 275% of next $114 of PIA, + 130% of next $114 of PIA, + 175% of PIA over $477. Adjust maximum formula like PIA formula.
Minimum PIA	Frozen at level in effect when proposal implemented.	Increases with CPI increases beginning in 1979.	Frozen at level in effect when proposal implemented.
Cost-of-Living Increases	Effective after retirement, death, or disability.	Effective with year of entitlement to retirement benefits, onset of disability, death (or 1979, if later).	Effective with year of attainment of age 62, entitlement to disability benefits, death (or 1979, if later).
Earnings Used for Recomputations	Not specified	Count dollar amount of earnings after the year to which earnings are indexed. 8/	Count at dollar amount of earnings after the year to which earnings are indexed.
Transition	Indefinite duration; guarantees benefit table effective at implementation without CPI increases.	5-year guarantee for all retirees who are age 62 after 1978 and before 1984; guarantee 12/78 benefit table after 1978 and prior to year of first eligibility (with CPI increases only from year of age 62 and use of earnings up to year of age 62).	Permanent; guarantees benefits in table at time of implementation. 10/

1/ These proposals are patterned after the general recommendations of the 1975 Advisory Council on Social Security.

2/ Apparently this is a technical defect.

3/ Worker's age-62 primary insurance amounts (PIA) as a percent of preretirement earnings for succeeding groups of retirees over time.

4/ The panel's report is not clear on this point, but the system would apparently index to eligibility. The report does not make recommendations for treatment of disability or death cases but says they must be studied further.

5/ Average indexed monthly earnings.

DECOUPLING THE SOCIAL SECURITY SYSTEM

Bentsen Bill (S. 559) 1/	Hsiao Panel Proposal (1976)	Whalen Bill (H.R. 836B)	Combination Proposal (SFC 7/77 Staff Paper)
1978	1980	1979	1978
To wages (assumes quarterly reporting 2/ of wages).	To prices	Not indexed	To wages
Constant	Declining	Constant	1978-87, constant; 1988-2030, declining; after 2031, constant
Earnings of workers who became entitled to retirement or disability benefits (unless worker recovered) or died, prior to 1978.	Not specified	Not applicable	Earnings of workers who attained age 62, had an onset of disability (unless worker recovered), or died prior to 1978.
Earliest of: Year before attainment of age 62, entitlement to disability benefits, or death, but not before 1977.	Year before attainment of age 62 but not before 1976. 4/	10 highest years.	Earliest of: Second year before entitlement to retirement benefits, onset of disability, or death, but not before 1976.
91% of first $175 of AIME, + 33% of next $875 of AIME, + 17% of AIME over $1050.	80% of first $200 of AIME, + 35% of next $400 of AIME, + 25% of AIME over $600. (Formula is for 1977; it would have to be updated for 1980 effective date.)	100% of first $110 of AME, + 31% of next $940 of AME, + 20% of AME over $1050.	91% of first $175 of AIME, + 33% of next $870 of AIME, + 16% of AIME over $1045.
Each year, adjust bend points by increase in average wages; round to nearest $.01.	Each year, adjust bend points by increase in the CPI. 7/	Each year, adjust bend points by increase in average wages; round to nearest $1.	Adjust bend points by increases in average wages; for 1988-2030, decrease percentage factor each year by half the gain in real wages.
150% of first $205 of PIA, + 275% of next $92 of PIA, + 129% of next $88 of PIA, + 175% of PIA over $385. No adjustment of maximum formula. 2/	In retirement cases, 120% of AIME (or 240% of the average AIME in two-worker families), but no more than 50% of PIA at the first bend point in PIA formula to a child. In disability and survivor cases--no recommendation.	150% of first $230 of PIA, + 275% of next $105 of PIA, + 130% of next $95 of PIA, + 175% of PIA over $430. Adjust maximum formula like PIA formula.	150% of first $245 of PIA, + 275% of next $95 of PIA, + 130% of next $115 of PIA, + 175% of PIA over $455. Adjust maximum formula like PIA formula.
Increases with CPI increases beginning in 1976.	Eliminates the minimum.	Eliminates the minimum.	Increases with CPI beginning with 1978.
Effective with year of attainment of age 62, entitlement to disability benefits, death (or 1978, if later).	Effective after retirement.	Effective after retirement, death, or disability.	Effective with year of entitlement to retirement benefits, entitlement to disability benefits, death (or 1978, if later).
Count at dollar amount of earnings after the year to which earnings are indexed.	Not specified	Count earnings after year of entitlement to retirement or disability benefits. 9/	Count at dollar amount of earnings after the year to which earnings are indexed.
10-year guarantee for all individuals who are age 62, entitled to disability benefits or die before 1988 and 10-year saving clause for family maximum; guarantees 12/77 benefit table after 1977 and prior to age 62, disability entitlement, or death (with CPI increases thereafter).	5-year guarantee for all workers born in 1917 to 1922, a benefit based on a combination of percentage of old-law benefit, (decreasing from 100% to 20% in equal steps over the 5-year period). For those born in 1922 and later a benefit based on new law only.	10-year guarantee for all individuals who are age 62, have an onset of disability, or die prior to 1989; guarantees 12/78 benefit table after 1978 and prior to year of death or first eligibility (with CPI increases only from year of age 62, onset of disability, or death).	5-year guarantee for all retirees who are age 62 after 1977 and before 1983; guarantee 12/77 benefit table after 1977 and prior to year of first eligibility (with CPI increases only from year of age 62 and use of earnings up to year of age 62).

6/ Average monthly earnings level at which the formula percentage changes.

7/ Consumer Price Index.

8/ Present law recomputation procedures would apply to workers who reach age 62 or have an onset of disability prior to 1979.

9/ The bill has a technical defect which does not permit the use of earnings after the year the worker reaches age 72.

10/ Applicable to persons with 1 quarter of coverage before 1978.

8/12/77

Specific Decoupling Issues

The essential elements of any decoupling proposal relate to:

(1) The measure of earnings—usually expressed as average monthly earnings, whether indexed or not.

(2) The computation period—whether or not the period for computing average monthly earnings would gradually increase as under present law or be limited to a shorter period.

(3) The benefit formula—whether or not the formula would approximate present law benefits at implementation and keep up to date with wages in the future.

These elements need to be considered together since virtually any change in any one of them will necessitate changes in the others and may give rise to the need for additional changes. For instance an explicit recognition of length-of-service might be incorporated if a short computation period is used or consideration given to a separate benefit formula for disability and survivor cases.

Under any proposal of this magnitude it is also necessary to make conforming changes in other provisions of the cash benefits program—e.g., the minimum benefit, the family maximum benefit. Under H.R. 8218, such changes have generally been designed to reproduce the effects of present law.

The following pages discuss these issues in terms of the Administration's bill.

Wage Indexing

A worker's earnings in each year after 1950 would be updated through the second year [2] before the worker retires.[3] Specifically, each year's earnings would be indexed by multiplying the actual earnings by the ratio of average wages in the second year before retirement to the average wages in the year being updated. For example, if a worker earned $3,000 in 1956, and retired at age 65 in 1979, the $3,000 would be multiplied by the ratio of average annual wages in 1977 ($10,002) to average annual wages in 1956 ($3,514), as follows:

$$\$3,000 \times \frac{\$10,002}{\$3,514} = \$8,539$$

Thus, while the worker's actual earnings for 1956 were $3,000, his relative or wage-indexed earnings would be $8,539. The worker's earnings each year would be adjusted in this manner. The result would be that the worker's benefits would be based on earnings levels that prevail just prior to retirement, disability, or, in the case of survivors, death. In effect, benefits would be based on the worker's relative earnings (that is, relative to average wages) averaged over the computation period. (See Computation Period.)

Wage indexing has the effect of treating high earnings the same regardless of whether they occur early or late in the person's working lifetime. As compared with present law, wage indexing tends to advantage workers with high relative earnings early in their career and disadvantage those with high relative earnings late in their career.

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[2] While it would seem reasonable to update earnings through the first year before the year of retirement, firm data on actual wage growth will not be available in time to allow for such current indexing. For 1978 and subsequent years, the law provides that earnings will be reported on an annual, rather than a quarterly basis. Thus, for example, data on average wage levels in 1980 will not become available in time to form an indexing basis for 1981 retirees; 1980 would be the indexing year for 1982 retirees. Another approach would be to use an estimated average wage for the year before retirement. (Suggested by Robert J. Myers.) However, this approach could cause problems if actual experience varied from the estimate; for example, people might complain if the actual average were higher than the estimate that had been used. This situation could lead to pressure for reindexing using actual wage data for such years, which would be an added program complexity.

[3] The year of retirement for this purpose is the year of initial entitlement—that is, the year for which the worker elects to receive retirement benefits (whether or not he actually is paid a benefit in that year), the year of onset of disability, or the year he dies.

Alternatives

Actual earnings.—H.R. 4870, the Whalen bill, would use actual earnings averaged over a 10-year period. If actual earnings are used, a fixed—rather than expanding—computation period would be necessary to assure that individuals' average earnings would grow at roughly the same rate as average earnings in the national economy. A fixed, short period, such as is provided in H.R. 4870, might invite pressure to add an explicit length-of-service measure, in order to distinguish between short- and long-term workers. (It would be difficult to devise an equitable length-of-service measure that would not give rise to windfalls or disadvantage low-paid regular workers.)

The benefit formula would have to be revised in order to replicate present-law benefits at the time of implementation or to produce whatever replacement rate levels were desired. Assuming a benefit formula designed to reproduce present-law benefits at implementation, program costs would be reduced somewhat more by the Administration proposal than by a proposal using a short, fixed computation period (such as is provided in the Whalen bill). This is true because the relative advantage of a short fixed computation would increase over time as the computation period under H.R. 8218 lengthens. While indexing the workers earnings under H.R. 8218 largely overcomes the effect of outdated earnings in a lengthening computation period, the longer computation period would act as a measure of continuity of covered employment. With a short, fixed computation period, a larger and larger number of years of low or no earnings could be excluded from the average period.

Basing benefits on actual earnings, as under present law, advantages workers who have high earnings late in their working lifetime as opposed to early in their career.

Price-indexed earnings (Hsiao Panel).—Under the Hsiao Panel approach, wages would be indexed in relation to the CPI to produce "price indexed earnings". Under this approach the system would be somewhat sensitive to the relationship between wages and prices but to a lesser extent than under present law.

Indexing earnings by the CPI injures the position of workers who have high earnings in their 20's but not as much as wage indexing. Thus price indexing provides some advantage but not as much as basing benefits on actual earnings as under present law, for workers whose earnings rise faster than the average toward the end of their working lifetime.

A comparison of average monthly earnings under various alternatives is shown below for people retiring at age 62 in 1979.[4] The differences would be even larger if the earnings were averaged over a 35-year period.

TABLE 8

Earnings pattern	Average monthly earnings			
	Present law [1]	Administration proposal	Hsiao panel	Whalen bill [1]
Increasing slower than average wages	$372	$712	$643	$455
Equal to average wages each year	500	836	814	669
Increasing faster than average wages (equal to contribution and benefit base each year)	678	1, 107	1, 062	1, 000
Level, $3,000 each year	250	582	506	250

[1] Actual, rather than indexed, earnings as under administration and Hsiao panel proposals.

[4] The average monthly earnings were calculated on the basis of a worker reaching age 62 in 1979 (rather than age 65) in order to facilitate comparison with the panel approach—the draft panel report lacks clarity with respect to the treatment of workers retiring after age 62. Elsewhere, where possible, age 65 has been used.

Computation Period

Under most of the major decoupling proposals, as under present law, benefits would be based on a worker's indexed earnings averaged over the period since 1950, when the worker could reasonably have been expected to have worked in covered employment, not counting the 5 years of lowest indexed earnings.[5] As under present law, the computation period would expand—from 20 years for those reaching age 65 in 1979, up to 35 years for those reaching age 65 in 1994 or later. If a worker's earnings increase at the same rate as average wages in the economy, indexing his actual earnings to changes in average wage levels would assure that his average indexed monthly earnings (AIME) would rise at the same rate as average wages in the economy, even though the computation period is expanding. Indexing according to changes in wage levels also generally would assure that the benefits payable to a worker (and his family) would be based on his relative earnings position—that is, relative to average wages in the economy.

The long computation period tends to distinguish between short- and long-term workers since, all other things being equal, the latter would have higher average earnings and would therefore get a higher benefit amount.

Alternative

Fixed, short computation period.—Relatively constant replacement rates could also be achieved with a fixed, short computation period. It could be fixed at 20 years or, alternatively, as under H.R. 4870, the Whalen bill, it could be fixed at 10 years. If the period is set at 10 or 20 years workers with 10 or 20 years of coverage could get the same benefit as workers with 35 or 40 years of service. Thus, consideration would probably need to be given to an explicit length-of-service factor.

While length of service with a single employer may not be unduly difficult to measure, application of this concept to a national program like social sccurity poses some problems. There is no feasible way to measure length of service in employment covered by social security that would not give rise to serious inequities. As a practical matter, use of quarters of coverage as a measure of length of service would raise a number of issues. It is possible for some workers to gain 4 quarters of coverage by having worked only a few weeks during a year—workers with maximum earnings and some self-employed people, for example. Further, records of quarters of coverage under social security prior to 1956 are not available in a form appropriate for machine processing.

An arbitrary dollar amount for each year could serve as the basis for determining length of service. However, if the amount were set relatively high—$2,000 in 1979, for example—some workers would get credit for a year of service even though they may have worked only a few weeks or months while others who worked for most of the year at low wages would not get credit. In addition regardless of what amount is selected, the amount would have to be adjusted annually to take account of rising wage levels; if not, eventually almost everyone would get credit for a year of service.

The shorter the computation period, the greater the opportunity for workers to manipulate their covered earnings, that is, they might work considerable overtime or in two jobs as they approach retirement in order to increase their average earnings as computed for benefit purposes and thus get "windfall" benefits.

Benefit Formula

The formula that approximates benefit amounts in present law applies to average monthly earnings, which are computed from the worker's actual or unindexed earnings in covered employment. As shown below, the present law formula has 9 steps. Each time the contribution and benefit base is increased, an additional step is added to the formula and each time there is an automatic benefit increase, the percentage factors in the formula are increased by the percentage increase in benefits.

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[5] Benefits based on earnings before 1951 would be calculated, essentially, as under present law—see page 30.

Though not stated in the law, the formula that roughly approximates the primary insurance amounts in the table in the law, effective June 1977, is:

145.90 percent of first $110 of AME,
53.06 percent of next $290 of AME,
49.58 percent of next $150 of AME,
58.30 percent of next $100 of AME,
32.42 percent of next $100 of AME,
27.02 percent of next $250 of AME,
24.34 percent of next $175 of AME,
22.54 percent of next $100 of AME,
21.18 percent of next $100 of AME.

The benefit formula in H.R. 8218, shown below, would be applied to the worker's average indexed monthly earnings (AIME). The formula is designed to approximate as closely as possible the benefit amounts payable to workers who retire in January 1979 (based on the assumption that the revised benefit structure would go into effect in that month) under present law:[6]

94 percent of the first $180 of AIME, plus
34 percent of AIME over $180 through AIME of $1,075, plus
16 percent of AIME above $1,075.

This formula would apply to those who reached age 62 and retire, have an onset of disability, or die in 1979. The dollar amounts (bend points)[7] in the formula would be adjusted automatically as average wages increase for those entitled in the future. A comparison of PIA's under present law and the proposal for selected average monthly earnings (AME) and AIME levels for January 1979 is illustrated in the following table:

TABLE 9

AME present law	AIME [1] proposal	PIA		Difference	
		Present law	Proposal	Amount	Percent
$50	$83	$121	[2] $121	0	0
76	126	121	[2] 121	0	0
110	182	171	170	−$1	−.6
200	331	220	221	1	.5
300	496	276	277	1	.4
400	662	333	333	0	0
500	827	385	389	4	1.0
650	1,075	472	474	2	.4
[3] 727	1,203	499	494	−5	−1.0

[1] In this table AIME and AME are "equated," for illustrative purposes, through the use of a general equivalence guide developed by the Office of the Actuary, Social Security Administration, rather than by an individual comparison of actual wage histories with and without indexing. As a result, the PIA's shown in the "proposal" column of the table are approximate and may not be the same as PIA's shown elsewhere based on AIME computed by actually indexing earnings.
[2] The minimum benefit guarantee, described under a separate heading is applicable.
[3] AME of $727 are the highest possible for the age-65 retirements in 1979.

Alternatives

(1) Unindexed earnings formula (Whalen)

Under H.R. 4870, benefit amounts would be based on the worker's 10 years of highest actual or unindexed earnings in covered employment. The specific benefit formula in H.R. 4870 is shown below. The dollar amounts (bend points) in the formula would be adjusted each year by the percentage increase in average wages, as under H.R. 8218.

100 percent of first $110 of AME, plus
31 percent of next $940 of AME, plus
20 percent of AME $1,050.

[6] The formula approximates the effects of present law at the beginning of 1979. A revised formula would be necessary to approximate later experience, say, 1980. The actual formula would be designed to approximate the benefit table in effect at the time of implementation. Of course, as provided under some of the alternative approaches the benefit formula could be changed so that it would weight benefits in favor of those with low earnings more or less heavily than is true under present law. This could be accomplished by changing the starting dollar amounts or by changing the applicable benefit percentages. The degree of weighting in the benefit formula is a controversial area on which consensus is difficult to achieve, since there are few, if any, objective standards.
[7] The bend points are the AIME levels at which the weighting in the benefit formula changes. The adjusted bend points would be rounded to the nearest multiple of $5.

(2) Lower general benefit levels (Myers)

The formula could be changed so that it would approximate benefit levels prevailing under present law sometime in the past—say before the ad hoc benefit increases of the early 1970's. If this were done, replacement rates would be stabilized at lower levels than those prevailing at the time of implementation, and greater reliance would need to be placed on a transitional provision to prevent sharp benefit reductions for large numbers of new retirees. The proposed formula for 1979 is:

82 percent of first $190 of AIME, plus
30 percent of next $760 of AIME, plus
10 percent of AIME over $950

(3) Price-indexing formula (Hsiao panel)

If the dollar amounts in the formula were adjusted as prices increase (as is generally done in price-indexing systems) rather than as average wages increase. replacement rates would decline in the future. (The decline would be even sharper if the bend points were not indexed at all.) The proposed formula for 1977 is:

80 percent of first $200 of AIME, plus
35 percent of next $400 of AIME, plus
25 percent of AIME over $600

(4) Combination approach—Index formula by a portion of real wage growth

Such a formula could be essentially the same as in H.R. 8218 for the first 10 years. During the 1988–2030 period the dollar amounts in the formula (bend points) would be adjusted to wages but the percentage factors would be decreased each year by 50 percent of the difference between average wage and price increases. Under this approach, replacement rates would decline but (in contrast to the price-indexing approach) the relative weighting of the benefit formula would be maintained. Such an approach is included in the Senate Finance Committee staff decoupling "combination plan" under which replacement rates would be stabilized at present-law levels at implementation for a period of about 10 years, then decline for a period of about 40 years, and then be stabilized again after 2030 at a lower level.

The Minimum Benefit

Under the Administration proposal, as under present law, the minimum benefit (now $114.30) would rise with prices. Thus, the minimum benefit (estimated to be $120.60 in January 1979) would rise (under the intermediate assumptions used in the 1977 trustees' report) to about $139 in January 1982, and by 4 percent per year thereafter. A worker coming on the rolls in the future would get the higher of the benefit based on the benefit formula applied to his AIME or the minimum benefit.

Since the minimum would only be adjusted by CPI increases and since wage levels, and hence benefit amounts based on those wage levels, are expected to go up at a faster rate than the cost of living, the trend should be for a smaller percentage of newly entitled people each year to get benefits based on the minimum. Although the minimum benefit is designed primarily to pay more adequate benefits to workers with low average earnings, it is also paid to higher income workers who qualify for benefits under another public retirement system and also qualify for social security benefits with very little attachment to employment covered by social security.

Alternatives

(1) Eliminate the minimum benefit prospectively.—Under this alternative, which was suggested by the Hsiao panel, a person with very low average earnings would get whatever benefit would result from applying the benefit formula to his average earnings.

Eliminating the minimum would result in sharp reductions in benefits for substantial numbers of people. (In recent years about 10 percent of awards to retired workers have been based on the minimum.) Thus, it would raise questions such as (1) the application of the transitional provision to workers with very low earnings and (2) the availability of SSI or other needs-tested payments for needy people affected by the change.

Under any of the decoupling proposals discussed herein, if this provision were applied to future beneficiaries, the long range program savings would be about 0.03 or 0.04 percent to taxable payroll.

(2) *Freeze the minimum benefit prospectively.*—For future beneficiaries, provide that initial PIA's would be frozen at an amount equal to the minimum PIA in effect at the time of enactment of the provision. After entitlement, benefits based on the minimum PIA would be updated to CPI increases as under present law. (Freezing the minimum benefit was recommended by the 1975 Advisory Council on Social Security and is included in the Myers decoupling proposal.)

Freezing the minimum would avoid the sharp drop in benefit amounts involved in the elimination of the minimum and would involve similar, though more gradual, reductions in future benefits for people with very low average earnings under social security.

Under any of the decoupling proposals discussed herein, social security costs would be reduced by about 0.02 percent of taxable payroll over the long range.

Maximum Family Benefits

Under H.R. 8218, maximum family benefits would bear the same relationship to PIA's as they do under present law—ranging from 150 percent to 188 percent of the PIA.[8] The family maximum would be determined by applying the formula shown to the worker's PIA:

150 percent of the first $245 of PIA, plus
275 percent of PIA's over $245 through $340, plus
130 percent of PIA's over $340 through $455, plus
175 percent of PIA's above $455

In the future, the dollar amounts (bend points) in the formula would be adjusted as average wages increase. A comparison of maximum family benefits at different earnings levels under present law and under the revised benefit structure is shown in the following table.

TABLE 10.—*Comparison of maximum family benefits in January 1979*

AME present law	AIME proposal	Maximum family benefits		Difference	
		Present law	Proposal	Amount	Percent
$50	$83	$182	$182	0	0
76	126	182	182	0	0
110	182	256	255	−$1	−.4
200	331	330	332	2	.6
300	496	452	456	4	.9
400	662	607	610	3	.5
500	827	705	692	−13	−1.8
650	1,075	826	812	−14	−1.7
[1] 727	1,203	872	846	−26	−3.0

[1] AME of $727 are in general the highest possible for age-65 retirements in 1979.

This treatment of the family maximum is similar to that in other decoupling proposals.

[8] Since the 1971 amendments the maximum family benefit has been related to PIA's at all earnings levels (rather than to average earnings as had previously been the case for higher paid workers). On the basis of this relationship to PIA, in 1979 the family maximum will be equal to 150 percent of PIA's up to an estimated PIA of $242.30. It gradually increases to 188 percent of an estimated PIA of $349.90 and then declines to 175 percent of PIA's at an estimated PIA of $459.10 and above.

Alternative

Flat-rate percentage maximum family benefit.—The family maximum could be made a flat-rate percentage of the PIA. This approach would be administratively less complicated and more easily understood by the public than the provision in the Administration proposal. However, if the maximum family benefits are set at a low percentage, say, 150 percent of PIA's or even an intermediate percentage, say, 175 percent of PIA's, many families would get substantially lower benefits than under present law, which would raise the question of whether a separate transitional provision for maximum family benefits should be provided. (The Administration's transitional proposal guarantees PIA's not family maximums because to do so would be an administrative complication.) On the other hand, if maximum family benefits were set at, say, 188 percent of PIA's (the highest percentage payable under present law), the cost of the proposal would be increased. At the 150-percent level, cost would be reduced.

Transitional Provision

The decoupled system proposed by the Administration is designed to closely approximate overall retirement benefits that would be payable at implementation (January 1979) under present law. However, it is unavoidable that some workers would receive somewhat higher retirement benefits and others somewhat lower under the new system than under present law upon implementation.

H.R. 8218 includes a 5-year transitional provision to protect the benefit rights of people who are now approaching age 62 and whose retirement plans have taken social security benefits into account. Under the provision, a worker who reaches age 62 after 1978 and before 1984 would be guaranteed a benefit no lower than he would have received under present law when the new system becomes effective (January 1979). The guarantee would not apply in disability and death cases. Benefits for workers who become disabled after 1978 and the survivors of workers who die after 1978 would generally be figured only under wage indexing.

The PIA for a worker reaching age 62 after 1978 and before 1984 (and his dependents or survivors) would be the higher of (1) the amount based on the benefit table in the law at implementation (the guarantee), (2) the minimum benefit, or (3) the amount derived by applying the new benefit formula to the worker's AIME.[9]

For purposes of the guarantee, the January 1979 benefit table would not be subject to future automatic benefit increases, but all individul benefits would be subject to all benefit increases becoming effective beginning with age 62. Earnings after age 61 would not be used under the guarantee computation. With the passage of time, benefits under the wage-indexing system would rise beyond the levels generally payable under the guarantee, since annual wage increases would be reflected in higher AIME and in the adjustments in the benefit formula each year. As a result, the proportion of newly entitled beneficiaries that would receive higher benefits under the guarantee would decrease with each passing year.

As shown below, it is estimated that the percent of new retirees eligible for guarantee benefits each year that would receive such benefits would decline from about 28 percent in 1979 to about 2 percent in 1983.

TABLE 11.—*Proportion of new retirees eligible for guarantee who would get benefits under guarantee during transitional period*

Year:	*Percent*
1979	28
1980	10
1981	6
1982	3
1983	2

[9] Under the guarantee the minimum is frozen at the 1979 level, and under the new benefit formula there would be no minimum. Thus, H.R. 8218 makes separate provision for a minimum benefit that rises with prices, as under present law.

A decoupling plan, such as that in H.R. 8218, that is designed to generally reproduce present law benefit levels for retired workers at implementation would result in an overall initial reduction in expenditures, primarily with respect to the disabled and to survivors. (See Benefits in Disability and Death Cases for discussion of the ramifications of having no transition guarantee.)

The following table shows a net cost *reduction* for the H.R. 8218 formula of $20 million in 1979. This figure reflects a *reduction* of about $55 million for disability and survivor cases which is offset by a cost *increase* of about $35 million in retirement cases. The table also shows the additional cost of providing a guarantee in retirement cases ($10 million) leading to a net effect of a $10 million overall reduction in expenditures for 1979.

TABLE 12.—*Estimated effect of administration proposal on OASDI benefit payments in calendar years 1979–83*

[In millions]

Year	Annual cost effect of H.R. 8218 without guarantee				H.R. 8218 guarantee (retirement only)	Net cost effect of H.R. 8218	
	Retirement	Survivor	Disability	Total		Each year	Cumulative
1979	$35	−$40	−$15	−$20	$10	−$10	−$10
1980	125	−100	−105	−80	25	−55	−65
1981	240	−175	−225	−160	35	−125	−190
1982	370	−255	−375	−260	40	−220	−410
1983	510	−345	−550	−385	45	−340	−750

Alternatives

(*1*) *No transitional provision.*—Elimination of the transitional provision would be an administrative simplification and increase the early year saving under the proposal. However, it would disadvantage some people who are approaching age 62. (All the major decoupling proposals make some provision for a transitional period.)

(*2*) *Extend guarantee to disability and death cases.*—The guarantee could be extended to apply to all beneficiaries, not just to retirees and their families. This approach would perpetuate to some extent the situation under present law where higher benefits can be paid in early death and disability cases than in retirement cases and also continues present work disincentives for some young disabled workers. (See Benefits in Disability and Death Cases.) It would also involve a substantial early-year cost—$2.1 billion over the 5-year transitional period.

(*3*) *Ten-year transition.*—The transitional period could be expanded to a period of 10 years. This approach would extend "guarantee" protection to some additional retired workers (and to a significant proportion of additional disability and survivor cases, if included) as compared with a 5-year transition. It has higher program and administrative costs than a 5-year transition. (Under H.R. 14430, last year's administration bill, the transitional period was 10 years and applied to death and disability cases as well as to retirement cases.)

(*4*) *Indefinite transition.*—The transitional provision could be retained indefinitely to assure that no one would be disadvantaged under the proposal as compared with present law at implementation, regardless of when a person became entitled to benefits. This approach is included in the Myers proposal under which decoupled-system replacement rates would be significantly lower than those under present law at implementation.

(5) *Hsiao panel transition.*—Under this approach, benefits during a 5-year period would be a "blend" of present-law benefits and the decoupled-system benefits. This approach is not designed to protect the benefit rights of people near retirement at implementation. Rather, it would phase out the present coupled system gradually to allow for a period of adjustment to a decoupled system. Twenty percent of the benefit of an individual becoming eligible for benefits in the first year of implementation would be computed under the new system and 80 percent under the provisions of present law. In the second year, the blend would be 40–60, and so on.

Benefits in Disability and Death Cases

Under present law, benefits in young disability and death cases can be significantly higher than in retirement cases. The major reason for the higher benefits is that earnings are generally averaged over less than 20 years—2 years in some cases—while, in retirement cases, earnings are averaged over 20 years. Moreover, the benefit differential will grow in the future as the computation period for retirement benefits expands. Under the Administration bill, H.R. 8218, the relative significance of the length of the computation period would be substantially reduced since all prior years of earnings would be indexed to reflect changes in earnings levels since the year the earnings were paid. Thus, average earnings in retirement cases would closely approximate average earnings in early disability or death cases.

In addition, the benefit formula in H.R. 8218 is designed to replicate benefit levels prevailing in retirement cases under present law at implementation. The overall effect of wage indexing and the new formula is a substantial reduction in benefits in early disability and death cases. This reduction to a large degree would deal with the criticism that the high benefits can act as a disincentive for disabled workers, particularly young ones, to return to work or to seek vocational rehabilitation. (The Administration bill last year, H.R. 14430, would have had a similar effect, but, unlike H.R. 8218, provided for a 10-year guarantee so there would have been a gradual, rather than a sharp, reduction in benefits.) For instance, under existing law an individual retiring at age 65 in January 1979 with average earnings would have a retirement benefit of $399 a month as compared to the benefit of $540 awarded a worker age 29 or younger who becomes entitled to disability benefits at the same time. Under the new Administration bill the two benefits would be virtually the same; $339 for the retirement case and $403 for the young disabled worker.

Some differential would remain for many years with regard to maximum (and above maximum) workers.[10] And some differential in benefit amounts would persist due to other factors (such as insured status requirements). Nevertheless, the basic elements of the present social security program that result in the higher benefits in early disability and death cases—the use of actual (nominal) earnings in a long (and growing) averaging period—would be substantially modified.

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[10] If all years used in computing retirement benefits for maximum earners reflect the same relative earnings base level, the base would not be a factor resulting in higher benefits in disability and death cases. However, the base has increased faster than average wages and would continue to rise faster under H.R. 8218 until 1985.

TABLE 13.—*Comparison of projected young death and disability primary benefits (PIA's) and replacement rates under present law and H.R. 8218 for illustrative cases of regular workers with earnings at low, average, and maximum levels* [1]

Year of entitlement	Low earnings [2]		Average earnings [2]		Maximum earnings [2]	
	Present law	H.R. 8218	Present law	H.R. 8218	Present law	H.R. 8218
PIA's:						
1979	$349.90	$254.90	$539.70	$402.80	$678.30	$529.50
1980	386.20	275.50	588.70	435.30	735.30	569.80
1981	424.90	296.40	638.60	467.70	796.80	613.90
1982	465.10	316.90	686.00	499.90	857.00	648.20
1983	506.00	337.20	733.60	531.30	917.80	702.50
PIA's as a percent of prior year earnings:						
1979	80	58	62	46	47	37
1980	82	59	62	46	48	37
1981	84	59	63	46	48	37
1982	86	59	63	46	48	37
1983	89	59	64	46	48	37

[1] The table (1) gives PIA's for January of year shown, (2) gives annualized replacement rates, and (3) assumes disability or death occurs before age 30 and that there are no earnings in year of entitlement.

[2] The 1976 earnings levels of $4,600 for low earners, $9,200 for average earners, and $15,300 for maximum earners are adjusted annually according to the intermediate set of assumptions used in the 1977 annual report of the Board of Trustees of the Federal OASDI Trust Funds.

Alternatives

Limit of Benefits

H.R. 15630, introduced by Chairman Burke in the 94th Congress, would have limited the PIA in disability and survivor cases to the highest PIA payable to a worker who reached age 65 in the same month as the worker who became disabled or died. No similar proposal is contained in Mr. Burke's disability bill, H.R. 8076, introduced in the 94th Congress.

Under present law, such a proposal would alleviate the large dollar differences between PIA's in retirement and in disability and death cases at higher earnings levels. However, under H.R. 8218, these differences would be greatly reduced and the fact that the Administration's bill this year does not have a guarantee for such cases makes such a "cap" less necessary. In either case, such a limitation would not have any effect on the differences at lower earnings levels.

Explicit Limit on Earnings Replacement

The Health Insurance Association of America (representing private disability insurers) testified that disability benefits (including workmen's compensation) should never exceed 65 percent of gross earnings at the time of disability. This would constitute a fairly major deliberalization of existing law. In order to avoid benefit levels for families in early disability and death cases from being excessive in terms of prior earnings levels, a limit on the percentage of average indexed monthly earnings (AIME) replaced by the benefits could be established. For example, if a limit of, say, 80 percent of AIME was instituted, the benefits of workers with AIME of $235 or less and the families of workers with AIME of $910 or less would be reduced. The effect would be especially marked in early disability cases where wage indexing would also act to substantially reduce benefits. An alternative to this approach would be to have a limit which varied by AIME from, say, 100 percent at the lowest level to, say, 40 or 50 percent at the highest.[11] Other variations are possible depending upon how much benefit adequacy as opposed to work incentive one wishes to

Separate Formula

A separate compatation could be provided for disability and survivors' benefits than is used for retirement benefits, or each of these programs could have its own formula.

[11] The HIAA stated that the formula should not exceed 30 percent for incomes in excess of $15,000.

Base Year for Indexing Earnings

An insured worker's earnings would be indexed by average wage increases in covered employment through the second year before the worker retires (that is, becomes entitled to retirement benefits), becomes disabled, or dies.[12] The earnings in the year prior to retirement would be counted in the actual dollar amount. The year of retirement is the year a worker elects to receive benefits (whether or not he is actually paid a benefit for that year). Because earnings will be reported in the future on an annual (rather than a quarterly) basis, average wage figures will not be available in time to index the earnings to a later year. (The same provision was included in H.R. 14430.)

A major issue to be considered is whether earnings should be indexed to age 62 (the age of first eligibility) rather than to retirement (first entitlement). The use of retirement as the base year for indexing rewards workers who stay in the work force for the longest time because benefits would reflect the increase in average wages that occur after age 62. The following table[13] compares PIA's under retirement indexing to age 62 indexing for a worker with average earnings each year retiring at different ages in the future.

TABLE 14

	Age at retirement in January	PIA's: Index to—		
		Retirement	Age 62	Difference
Year of retirement:				
1979	62	$392.30	$392.30	0
1980	63	424.40	414.90	$9.50
1981	64	457.20	439.10	18.10
1982	65	489.70	462.30	27.40
1983	66	521.10	486.90	34.20
1984	67	552.90	513.50	39.40
1985	68	584.70	543.40	41.30
1986	69	618.10	576.00	42.10
1987	70	652.60	612.60	40.00
1988	71	688.80	652.50	36.30
1989	72	729.70	696.60	33.10

When retirement occurs after age 62, indexing to retirement produces higher benefits than indexing to age 62 because (under current assumptions that wages increase faster than prices) benefits for workers of the same age retiring in successive years whose earnings are indexed to retirement would increase at least as fast as wages while their benefits, if indexed to age 62, would increase no faster than prices.

Alternative

Age 62.—Earnings could be indexed up to the second year preceding age 62 rather than retirement.

This alternative provides less incentive for a worker to remain in the work force since, all other things being equal, the worker who retires at age 62 and the worker who retires 3 years later at age 65 will receive benefits based on approximately the same PIA. If it is believed necessary to provide additional work incentives under age-62 indexing consideration could be given to increasing the delayed retirement credit.

Indexing earnings to age 62 in all cases, as under this option, would seem to give official sanction to a lower retirement age. On the other hand, the argument that indexing to the date of retirement would reward individuals who work longer fails to take into account that many people normally go back and forth

[12] Since the retirement test does not apply after age 72, there is no program-related reason for insured workers to delay filing beyond age 72, and virtually no beneficiaries start getting benefits after age 72. A technical change should be made in the bill so that earnings would not be indexed to a year after the year a worker reaches age 70 (the second year prior to the year he becomes age 72).

[13] Based on intermediate set of economic assumptions used in the 1977 Annual Report of the Board of Trustees of the Federal OASDI Trust Funds.

between employment and retirement. These individuals would receive lower benefits permanently than they would if they had been well-informed and not applied for benefits.

If the CPI is rising faster than average wages, the worker would be better off, in general, the earlier the point to which his earnings are indexed. In this situation, indexing to age 62 would be to the worker's advantage, while under indexing to retirement the worker would be better off to elect benefits at an earlier date—that is, there would be an incentive to retire early.

This alternative has some significant advantages in the areas of administration and public relations. Since the indexing point is based solely on date of birth rather than on the year retirement benefits are elected, this alternative would relieve the worker of the burden of having to decide the most advantageous time for him to elect benefits, a decision which would affect the benefits he and his family would receive from then on. In addition, there would be less pressure on SSA field personnel to make certain that the worker understood the significance of his choice of when to elect benefits and to provide him the information necessary to be able to make the choice.

Since age-62 indexing is less complex from an administrative standpoint, administrative costs would be lower than if earnings were indexed to retirement.

Treatment of Earnings after Retirement or Disability Under Decoupling

Under the Administration proposal, earnings subsequent to the year of retirement—that is, entitlement to retirement benefits—or onset of disability would be counted at actual dollar value (i.e., unindexed) and substituted for earlier years of indexed earnings if they would increase a worker's AIME and his PIA. The recomputation provisions are similar to those under present law. However, since past earnings would be higher after wage indexing than under present law, earnings after retirement would, on the average, have substantially less effect in increasing benefit amounts than under present law. (This approach is similar to that in H.R. 14430 and in other current decoupling proposals.)

Alternative

Reindex earnings after retirement or disability.—Under this alternative, for each year a worker had earnings after he became entitled to benefits, his earlier earnings would be reindexed to take account of the year of additional earnings. Thus, a worker who had earnings after retirement or disability would be assured that his PIA would increase from year to year as fast as the increase in average wages.

Reindexing all of a worker's earnings whenever he had 1 additional year of earnings would be a very significant administrative complication. After a worker's earnings were reindexed, a new benefit computation would have to be done and the resulting PIA (without cost-of-living increases) would have to be compared to the previous PIA (with cost-of-living increases)to see which is higher. This operation would have to be done every year a worker had earnings after initially becoming entitled to benefits. In 1976 3.3 million (about 20 percent) of retired-worker beneficiaries over age 65 had earnings.

Reindexing would also raise a question of equity as between retired workers with very low covered earnings in a year and those with none. If a worker's PIA were increased by the increase in average wages due to reindexing even if he had very low earnings in a year, such a worker would be very substantially better off than the person with no earnings. A provision for an earnings threshold to qualify for reindexing would eliminate that particular equity problem but the threshold would be necessarily arbitrary and therefore the provision would create other equity problems. Also, reindexing would add substantially to program costs. On the other hand, in a decoupled system based on retirement indexing (such as H.R. 8218), reindexing would increase equities between workers with similar wage records retiring in successive years. But reindexing would reduce the incentives for later retirement that retirement indexing is specifically designed to provide. (Of course, this question would not arise under a system based on age-62 indexing.)

Treatment of Earnings After Age 62 or Disability for Workers Age 62 or Disabled Before 1983

Workers age 62 or disabled before 1979

For workers age 62 or disabled before 1979, the present computation and recomputation procedures would apply. Such workers could not qualify for wage indexing. (H.R. 14430, last year's administration bill, provided that such workers would have their benefits computed under present law but without the use of earnings after the effective date, and that they could qualify for wage indexing under certain conditions if they had earnings after such date.)

Workers age 62 from 1979 through 1983

For those age 62 during the transitional period, present-law computation procedures would apply as a guaranteed alternative to the wage-indexing system. (The benefit table would be frozen at January 1979 levels and only adjusted for cost-of-living increases after a person reaches age 62.) However, earnings after age 61 could only be used in a wage-indexing computation. If the wage-indexed benefit did not exceed the guarantee benefit, the latter would be paid. Earnings in subsequent years would be used in wage-indexing recomputations until the wage-indexing benefit exceeded the guarantee benefit; thereafter the wage-indexing benefit would be paid. (H.R. 14430 contained the same provision. However, the transition was 10 years and applied to disability cases as well as to retirement cases.)

Alternative

For workers age 62 (or disabled) before 1979, permit earnings after 1979 to be used only in a wage-indexing recomputation.—This alternative—contained in H.R. 14430—would make it possible for people age 62 or disabled before 1979 to qualify for wage indexing if they had earnings after 1978. However, some people would qualify for wage indexing under this alternative based on relatively low additional earnings and get a substantial increase in their benefits because of the effect of indexing wages. Of course, since such earnings could not be used for a present-law recomputation, this alternative would be a considerable deliberalization for others.

Treatment of Earnings Before 1951

Under present law, PIA's are determined based on average earnings after 1936, 1950, or age 21, if later (and up to the year of age 62, disability, or death) whichever results in the higher PIA. Special rules apply where pre-1951 earnings are involved in the computation of benefits, and these rules would be retained under the Administration proposal.[14] Thus, pre-1951 earnings would not be indexed since machine records do not include yearly breakdowns of earnings for the period 1937–50. Indexing individual years of earnings before 1951 could only be done on a manual basis, an operation which is not administratively feasible. People age 62 after 1978 who are eligible for a computation using pre-1951 earnings would have their benefits figured under present law using a 1979 benefit table with CPI increases after age 62, death, or disability. However, earnings after age 62 or disability would not be used in the old-start computation. For all practical purposes, the use of pre-1951 earnings in benefit computations would wash out in 1991—when a worker age 22 in 1951 reached age 62. The old-start computation is currently used for about 10 percent of new retired worker beneficiaries.

That is the same as provision in H.R. 14430, last year's Administration bill, except that the "empirical" method would be extended under the Administration bill to cases involving workers age 21 after 1937; the extension has

[14] As under present law, the simplified "empirical" method of allocating total earnings prior to 1951 to individual years prior to 1951 would continue to be used. Because earnings in the period 1937–50 are not kept on machine records, the empirical method was devised to simplify the computation of benefits for workers who had earnings before 1951 by eliminating the time-consuming manual computations that would otherwise have to be done. In general, under the empirical method, total earnings in the period from 1937 up to 1951 are allocated equally to each of the years prior to 1951 that are used to determine the worker's average earnings on which his benefit is based.

also been proposed under present law. Also, the treatment of pre-1951 earnings under H.R. 4870 (Whalen) would be the same as under H.R. 14430. Under the Myers approach, pre-1951 earnings also would not be indexed. The Hsiao panel made no recommendations for treatment of pre-1951 earnings after the transitional period. (During the transition the present law computation applicable in the case of pre-1951 earnings would be used to figure the present law portion of the benefit.)

Alternative

Develop an empirical method of indexing pre-1951 earnings.—Although it is not administratively feasible to index earnings for the period 1937–50, a simplified approximation of indexed earnings for this period could be used. Under such an approach, total earnings for 1937–50 which are contained in SSA machine records would be allocated equally to each of the years in the period and then indexed. However, indexing earnings that have been arbitrarily allocated and bear no relationship to the worker's actual year-by-year earnings would not accomplish the purpose of indexing, which is to bring each year's earnings up to date with current wage levels. Also, such an approach would involve considerable administrative complexity.

Effective Date

The Administration's wage-indexing proposal would be effective for monthly benefits payable beginning with January 1979. Since the system would operate on a calendar-year basis—for example, earnings would be indexed and the benefit formula would be adjusted annually—a January effective date seems desirable.

Alternative

All the major decoupling proposals use a January effective date. Obviously, decoupling represents a major restructuring of the social security program requiring very substantial changes in the mechanism for determining social security benefit amounts. In order to assure smooth implementation of the decoupled system, it might be necessary to allow some 18 months or more lead time after enactment. If the effective date of H.R. 8218 were delayed 1 year, the long-range savings would be reduced by 0.03 percent of taxable payroll.

Conforming Amendments Under Administration Bill

1. *Family maximum* (section 203 of the bill and section 203(a) of the Social Security Act):

(*a*) *In special minimum benefit cases*, where the worker becomes eligible for the special minimum or dies after December 1978, the family maximum benefit would be figured using the family maximum formula under wage indexing. (Under H.R. 14430 this change would have been effective with respect to all special minimum family maximums determined after the effective date of decoupling.)

(*b*) *Where an individual is entitled on the basis of more than one PIA*, and one or more of those PIA's is based on wage indexing, the family maximum benefits on each PIA would be combined up to 1.75 times the highest wage-indexed PIA. (Under present law the limit in such cases is the highest family maximum benefit appearing in the benefit table, which is 1.75 times the highest PIA.)

2. *Other conforming amendments* (section 204 of the bill):

(*a*) *Sole survivors.* Section 202(m) of the Social Security Act is amended to assure that under the new system, as under present law, the minimum unreduced sole survivor's benefit will be equal to the minimum PIA.

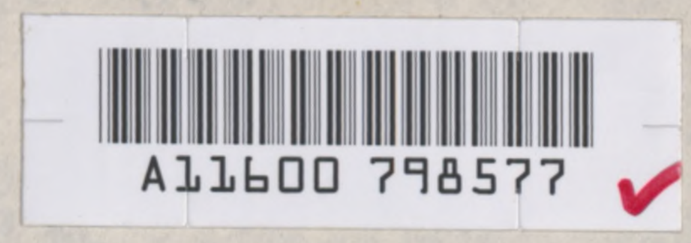
(*b*) *Insured status for certain veterans.* Section 217(b) of the act is amended to retain present special insured status provisions for certain World War II veterans.

(c) *Use of AME for figuring the workmen's compensation offset.* Section 224(e) of the act is amended to provide that AME, rather than AIME, will continue to be used in determining average current earnings for purposes of the workmen's compensation offset. Use of AIME could result in increasing benefits payable under the offset provision.

(d) *Filing for medicare only.* Section 226(a) of the act is amended to permit a worker who plans to continue working to establish entitlement to medicare at age 65 without having the wage-indexing point for purposes of figuring his PIA (and hence the amount of his PIA) determined by the date he elected medicare. (Under present law, a worker must become entitled to cash benefits to qualify for medicare.)

(e) *Revise the method of adjusting the SMI premium.* Section 1839(c) of the act is amended so that the SMI premium will be increased each year by no more than the same percentage as benefits for people on the rolls are automatically increased. This change is necessary since the premium adjustment is now tied to increases in the benefit table, which would have limited applicability as of January 1979 under the decoupling proposal, and would eventually wash out.

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