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STATE AND LOCAL GOVERNMENT TERMINATIONS OF SOCIAL SECURITY COVERAGE

AN INFORMATION PAPER

PREPARED FOR THE

SPECIAL COMMITTEE ON AGING

UNITED STATES SENATE

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PREFACE

Four years ago, prompted by concern about the increased number of State and local government entities electing to terminate social security coverage, this committee published a working paper [1] on the impact of these terminations on the employees involved. The working paper focused on the financial effect of the terminations on the social security system, and, more importantly, the potential impact the loss of social security coverage may have on workers and their dependents.

There was concern in some sectors that the decision to end social security coverage was being made in a haphazard manner. Some suggested that workers too often failed to consider the possible consequences of their decision to end social security coverage, or lacked the basic knowledge to enable them to make an informed decision.

For the majority of older Americans, social security has been, and will likely continue to be, a cornerstone of economic support in the years after retirement. It is for this reason that the committee remains concerned about the future retirement plans of those State and local government employees who either elect to end their involvement in the social security system, or are withdrawn from the program in spite of their desire to retain social security protection.

The previous working paper was done at a time when terminations from social security were thought to be at an alltime high. And yet, 4 years later, the situation has not improved. The number of groups leaving the program has steadily increased over the past several years, and for the first time in the history of the program, the number of State and local government employees whose coverage was terminated in a given year has exceeded the number becoming newly covered.

The committee believes this continuing upward trend in the number of people opting out of social security deserves attention. Therefore, the committee has undertaken this report to update and supplement the information in the previous paper on this subject. In preparing this report, the committee has taken a close look at the reasons for the upswing in terminations and the effect this may have on employees and their dependents. Much of this information was obtained by the committee through a nationwide survey of State and local government groups which have either recently considered terminating social security coverage, or are currently in the process of making that decision.

Naturally, in order to establish what effect the loss of social security can have on workers, it is crucial to understand the value of the program. As much as possible, the committee has presented this information with dollars and cents examples, and has developed guidelines with which to evaluate the relative merits of social security protection and other typical retirement plans. What effect the loss of social security

[1] "Termination of Social Security Coverage: The Impact on State and Local Government Employees," September 1976.

coverage will have for any particular person or group depends upon many factors, including age, salary level, and number of dependents. Loss of social security coverage is not detrimental to every individual in every circumstance, and this report presents arguments for and against social security coverage. However, the committee believes that the problems that can arise from loss of social security coverage are serious and widespread enough that anyone planning on terminating that coverage should give the idea careful consideration before reaching a decision. The committee hopes that this report will be helpful in that process.

In addition to the problems individuals may encounter when social security coverage is lost, there are significant problems for the program as a whole that arise from the way in which State and local government employees are covered by social security. These problems affect all the workers who support the program with their tax dollars, as well as the millions of program beneficiaries. Therefore, this paper also concerns itself with the rationale for present law and the problems that can arise under the present law.

Social security is a large and complex program. For this reason, the public at large is often unaware of many of the program's benefits, and may, therefore, underestimate the value of social security. The committee has tried to present a clear and understandable picture of the true worth of social security. Thus, while this report is designed largely to address social security coverage for State and local workers, it is our hope that it will be of interest to many other workers who are paying to support a program they may not fully understand or appreciate.

The committee wishes to express its profound appreciation to the groups who offered their frank and candid feelings about the social security program and responded to a lengthy and detailed questionnaire. We would also like to thank the Social Security Administration for their cooperation and valuable technical assistance. Finally, the committee adds a special thanks to Lynn Shiller, who was instrumental in the development of this report.

LAWTON CHILES,
Chairman.
PETE V. DOMENICI,
Ranking Minority Member.

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STATE AND LOCAL GOVERNMENT TERMINATIONS OF SOCIAL SECURITY COVERAGE

Chapter 1

SOME QUESTIONS AND ANSWERS ABOUT SOCIAL SECURITY COVERAGE FOR STATE AND LOCAL GOVERNMENT EMPLOYEES

Question No. 1

Why aren't State and local government employees automatically covered by social security, like most other workers?

Answer

When the Social Security Act was enacted in 1935, employees of State and local governments were excluded from mandatory coverage because of the question of the constitutionality of levying the employer portion of the Federal Insurance Contributions Act (FICA) tax on the States.[1] This constitutional issue was reflected in the 1939 report of the Social Security Board to the Committee on Ways and Means of the House of Representatives. The Board stated that "no method has yet been devised which would overcome constitutional difficulties and also protect the old-age insurance system against adverse selection".[2]

Question No. 2

How were the problems involved with providing social security coverage for employees of State and local governments overcome?

Answer

Soon after the original Social Security Act was passed, it became clear that many State and local workers desired social security protection. Several States requested social security coverage for employees not protected under a retirement system, but opposed cover-

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[1] Two other major groups were also excluded from social security coverage:
Federal employees were excluded from social security coverage because they were protected by the Federal Civil Service Retirement System which was already well established.
Employees of nonproft organizations were excluded under the Social Security Act of 1935 because of a concern that nonprofit organizations would lose their tax-exempt status if social security coverage was mandated. These organizations were later given the option of electing coverage for their employees without abandoning their tax-exempt status.

[2] "Adverse selection" is the term frequently used to indicate that the social security trust funds would be made financially vulnerable if social security coverage could be chosen on an individual basis. Such a provision would adversely affect the program's financing because, presumably, only individuals who expect to get a very favorable return on their taxes would elect (select) to join the social security program, thus increasing the cost of the program.

age for employees already under a State or local retirement system. This opposition was based on the belief that State and local governments might not support two retirement systems and the State or local retirement system might be abandoned if social security coverage were obtained.

In response to these two opposing concerns, the Social Security Amendments of 1950 extended coverage to State and local employees not covered under a retirement system. To overcome the possible constitutional difficulties involved with mandating social security coverage for State and local government workers, this coverage was provided on a voluntary basis and only if the State requested to enter into an agreement with the Secretary of Health and Human Services (HHS) (formerly HEW).

To avoid the problem of adverse selection, coverage was provided only for groups of employees called "coverage groups." In general, all of the employees of a State or a political subdivision not under an existing retirement system constituted a coverage group, and with the exception of certain minor groups of employees that were excluded compulsorily, or could be excluded at the option of the State, all employees in a coverage group had to be covered if any were to be covered. The State decides, within the limits of Federal and State law, which groups of employees are to be covered and when coverage is to begin.

Question No. 3

Why was coverage extended to most State and local employees already covered by a public retirement plan, but not to police and firefighters?

Answer

At the request of State and local groups, legislation enacted in 1954 expanded coverage of State and local government employees by extending coverage to employees covered under public retirement systems. Once again, coverage was provided on a voluntary basis for all members of a coverage group provided that the State enters into an agreement with the Secretary of HHS requesting that coverage. At the request of their representatives, police and firefighters continued to be excluded from coverage.

Question No. 4

Can police and firefighters get social security coverage now?

Answer

Police and firefighters can be covered by social security. Legislation passed in 1956 permitted coverage for these employees in five specified States that had requested such action. This provision was extended to additional States when the State clearly desired to provide such coverage. At present, this provision applies to 22 States, Puerto Rico, and all interstate instrumentalities. Further, in 1967, the law was amended to allow all States to provide social security coverage for firefighters covered under a State or local retirement system when the State certifies that the social security coverage would improve the overall protection available to the firefighters.

Question No. 5

Do State and local employees have a voice in the decision to join the social security program?

Answer

Under Federal law, a State may provide social security coverage for employees who are not already covered by a retirement plan regardless of the desires of the employees. (In reality, however, State law often prevents this.) However, before coverage can be provided to employees already under a retirement system, Federal law requires that the employees be given an opportunity to vote for or against social security coverage.

Question No. 6

What happens when some members of a coverage group that is already under a retirement plan want social security coverage and others don't?

Answer

For employees already covered by a retirement plan, the law provided that a majority had to vote approval of social security coverage before any of them could be covered by social security. However, a new approach was developed because Congress believed that the requirement that all members of a State or local retirement system be covered if any are covered to be too restrictive, and placed an "undesirable limitation upon the ability of States to afford employees the combined protection of the basic Federal system and a State or local retirement system." Thus, a new approach, called the "divided retirement system" provision, was enacted in 1956 to allow social security coverage to be extended to only those members of a retirement system group who desire such coverage, with the requirement that all new employees of that retirement system group be covered mandatorily. Again, this requirement was designed to protect the social security trust funds from adverse selection.

This provision of the 1956 legislation originally applied to eight specified States and what was then the Territory of Hawaii at the request of these entities. At present, however, the provision is available to 21 specified States and all interstate instrumentalities.

Question No. 7

For employees already covered by a retirement system, was there any safeguard to insure that they would not lose overall protection?

Answer

When social security coverage was made available to retirement system members, the legislation contained language stipulating that it was the policy of the Congress that there be no impairment of the protection afforded members and beneficiaries of a retirement system because of the extension of social security coverage.

Question No. 8

Once a position becomes covered by social security, how long does it take for an employee to become insured for social security benefits?

Answer

Before workers and their families can get retirement, survivors, disability, or hospital insurance protection, the workers must earn a certain amount of social security work credits or quarters of coverage (QC's). A QC is the basic measure of determining eligibility for social security benefits. In 1980, a worker earns one QC for each $290 of covered wages, up to a total of four in a calendar year. The amount of covered earnings needed to earn one QC goes up as wages go up, so that, for example, in 1981, a worker will need $310 in covered wages to earn a QC.

The amount of QC's needed to be eligible for social security benefits depends on the worker's age and the type of benefit being applied for. As a general rule, however, workers need at least 6, and not more than 40 QC's. If the worker has enough credit to be entitled to benefits, payments can also be made to the worker's dependents. QC's earned any time after 1936 can be used in determining eligibility.

The table below shows the number of QC's a worker needs to be eligible for retirement benefits:

If you reach 62 in:	*Quarters of coverage you need*
1976	25
1977	26
1978	27
1979	28
1980	29
1981	30
1983	32
1987	36
1991 or later	40

In some cases, survivors benefits can be paid if a worker has fewer QC's than the number required for retirement benefits. One QC is required for each year:

—After 1950 and up to the year of death, if the worker was born in 1929 or before; or

—After the year the worker reaches 21 and up to the year of death, if the worker was born in 1930 or later.

Regardless of when the worker was born, however, monthly payments can be made to surviving dependent children if the worker has six QC's in the 3 years before the worker's death. Moreover, the worker's widow or widower also may be eligible for benefits if caring for children under 18 or disabled who are entitled to benefits based on the worker's earnings under social security.

For disability protection, the number of QC's needed depends upon the worker's age at the time he or she becomes disabled. If, at the time the worker becomes disabled, he or she is:

—Under 24, the worker must have six QC's out of the 3-year period ending when disability begins.
—24 through 30, the worker must have credit for having worked under social security for half the period from the time he or she reaches 21 until becoming disabled.
—31 or older, the worker must have credit for at least 5 years of work out of the 10 years ending when he or she became disabled (in other words, 20 QC's out of the previous 40 quarters). In addition, however, the worker must also be "fully insured"—that is, he or she must have one QC for each year after age 21, and up to the year in which he or she became disabled.

A person disabled by blindness does not have to meet the requirement for recent work under social security. However, a blind person does need credit for one QC for each year since 1950 or, if later, the year he or she reached age 21, up to the year he or she became blind. A minimum of six QC's is needed.

At age 65, workers and their dependents or survivors (also aged 65 or older) who are eligible for social security or railroad retirement benefits become eligible for part A (hospital insurance) medicare. In addition, individuals under age 65 who have been entitled to social security or railroad retirement benefits for 24 months on the basis of a disability are also eligible for part A benefits, as are insured workers and their dependents who have end-stage renal disease. People age 65 and over—and people under age 65 who are eligible for part A medicare—may buy part B (supplementary medical insurance).

Having enough QC's means only that workers and their families can become eligible for social security benefits. But the amount of the benefits depends upon the worker's average earnings over a period of years from wages covered by social security. The higher the earnings, the higher the benefits.

Question No. 9

How many State and local government employees are covered by social security?

Answer

As of March 31, 1978, approximately 9.2 million, or about 72 percent, of the 12.9 million State and local government jobs in the 50 States were covered by the social security program. Total State and local government employment increased about 15 percent in the 5-year period beginning March 1973, but the percent of those jobs covered by the social security program remained about the same.

Table 1 shows the number of State and local government jobs, the number of jobs covered, and the percent covered, in each of the 50 States. In 12 States, coverage is virtually complete, exceeding 95 percent. In only five States are less than 25 percent of the jobs covered.

TABLE 1.—ESTIMATES OF SOCIAL SECURITY COVERAGE OF STATE AND LOCAL GOVERNMENT JOBS, MARCH 1978 [1]

[Number of jobs in thousands]

State (ranked by number of jobs)	Number of jobs	Number of jobs covered	Percent covered
Total	12,889	9,230	72
1. California	1,400	597	43
2. New York	1,089	1,015	93
3. Texas	754	430	57
4. Illinois	605	233	38
5. Ohio	575	0	0
6. Pennsylvania	572	572	100
7. Michigan	564	505	89
8. Florida	497	415	83
9. New Jersey	427	427	100
10. North Carolina	344	315	92
11. Massachusetts	330	0	0
12. Georgia	327	273	84
13. Virginia	321	314	98
14. Indiana	292	260	89
15. Wisconsin	276	260	94
16. Missouri	266	198	74
17. Minnesota	254	181	71
18. Tennessee	253	218	86
19. Maryland	252	252	100
20. Louisiana	234	54	23
21. Washington	231	231	100
22. Alabama	214	214	100
23. Colorado	185	42	23
24. Iowa	182	169	93
25. South Carolina	181	176	97
26. Kentucky	179	132	74
27. Oklahoma	173	149	86
28. Oregon	162	153	95
29. Connecticut	161	101	63
30. Kansas	159	144	90
31. Arizona	155	146	94
32. Mississippi	145	140	97
33. Arkansas	115	114	99
34. Nebraska	110	105	95
35. West Virginia	107	103	96
36. Utah	87	76	88
37. New Mexico	84	71	85
38. Maine	67	24	36
39. Montana	66	50	75
40. Hawaii	58	42	72
41. Idaho	58	55	96
42. Rhode Island	52	38	73
43. New Hampshire	49	47	96
44. South Dakota	49	41	85
45. Nevada	48	3	6
46. North Dakota	47	37	80
47. Delaware	37	23	63
48. Wyoming	33	32	95
49. Alaska	33	24	74
50. Vermont	29	26	90

[1] Source: Social Security Administration, Office of Research and Statistics, Research and Statistics Note No. 10, Sept. 17, 1980.

Question No. 10

Once State and local government employees gain social security coverage, can that coverage be ended?

Answer

The Social Security Act permits termination of social security coverage for employees of State and local governments. However, to prevent adverse selection, employees cannot individually end social security coverage, just as they cannot, generally, elect social security coverage on an individual basis. Thus, termination of social security coverage applies to all employees in a group that terminates coverage.

Question No. 11

How is social security coverage terminated?

Answer

Under the terms of the Federal-State coverage agreement, the State may terminate the coverage agreement in its entirety or for one or more coverage groups. In order to do this, at least 2 years' advance notice of the intent to terminate must be sent by the State to the Secretary of HHS. Social security coverage must have been in effect for at least 5 years at the time notice is given. The termination notice may be withdrawn by the State at any time within the waiting period. In addition, if the group is still undecided about whether or not to terminate coverage, the State can request a one-time 1-year extension of the waiting period, without filing a new notice.

Question No. 12

How many State and local government entities have terminated their social security coverage?

Answer

For the past 21 years, States have had the option of terminating social security coverage for State and local government employees. During that time, the States have filed notices of termination of social security coverage for 1,112 State and local groups. Significantly, 53 percent (590) of those requests have been filed since 1976. Of the 1,112 requests to terminate, 145 were withdrawn, 700 have become effective and 267 are still pending. The 700 terminations that have become final affected approximately 130,000 employees. This figure represents only about 1 percent of all State and local government employees currently covered by social security. However, it is worth noting that, since 1977, for the first time in the history of the program, the number of State and local employees terminating coverage in a given year has exceeded the number becoming newly covered:

Year	Entities		Employees	
	Newly covered	Terminated	Newly covered	Terminated
1979	596	81	14,300	33,677
1978	722	113	17,050	20,305
1977	675	136	17,000	24,600
1976	762	54	20,000	8,117

Question No. 13

Prior to 1978, the law provided that, if the requirement for a 2-year waiting period had been met, a State could request that social security coverage for a group of State and local government employees be terminated as of the end of any calendar quarter. However, beginning with requests filed in 1978, termination can be effective only at the end of a calendar year. Why was this change made?

Answer

This change was needed in order to avoid giving an unfair advantage—as a result of a change in the way quarters of coverage (QC's) are earned under the social security program beginning in 1978—to groups terminating coverage before the end of a year. A QC is the basic measure used to determine eligibility for social security benefits. In order to be eligible for benefits, a worker must have earned a certain number of QC's. This number varies according to the worker's age and the type of benefit involved (retirement, disability, etc.). Workers acquire QC's when they earn at least a certain amount in a job covered under social security.[3]

Prior to 1978, employers reported their employees' earnings to the Social Security Administration (SSA) on a quarterly basis. It was, therefore, possible to establish clearly whether a quarter of coverage was earned in a specific calendar quarter. (Before 1978, a worker earned one QC for any calendar quarter in which he or she earned $50.) However, beginning in 1978, employers began reporting their employees' earnings only at the end of the year, so that it was no longer possible to assign earnings to a specific period of time within that year. Therefore, for work in 1978 and later, individuals acquire up to four QC's per year on the basis of the annual earnings, regardless of when the work was performed during the year (one QC is earned for each $310 of earnings in 1981).

This change could have meant that many employees in a group terminating coverage in the early part of a year would already have enough earnings to be credited with four QC's for that year, even though they were not covered under social security, and were not paying social security taxes, for part of the year. For this reason, it was decided to allow terminations only at the end of a calendar year.

Question No. 14

Can a group regain social security coverage once that coverage has been terminated?

Answer

Any State which terminates its coverage agreement in its entirety cannot enter into another agreement to cover any public employees in the State. If the termination applies only to a particular coverage group, the State's agreement cannot again become applicable to that coverage group.

Question No. 15

Do State and local government employees have a voice in the decision to terminate social security coverage?

Answer

While some States and localities require a referendum before social security coverage is terminated, the vast majority do not. Employees can, in fact, have their social security coverage terminated by the State without notice and without being given a voice in the decision. Since

[3] See question No. 8 for a description of how many QC's a worker needs to be insured for benefits under social security.

it is up to each State to determine how terminations are accomplished, there are no uniform standards on how much influence the employees themselves have in the decision, or how and when they are notified of the termination of their social security coverage.

Question No. 16

Why aren't there uniform requirements to protect State and local government employees' rights in the termination process?

Answer

In keeping with the voluntary nature of social security coverage for these employees, the Federal Government imposes no restrictions on the termination process other than those described previously (i.e., 2 years advance notice after termination has been in effect at least 5 years). Some constitutional concerns about States' rights might be raised if the Federal Government would unilaterally modify the Federal-State contract by mandating new restrictions in the termination process, even if the restrictions were designed to protect employees' rights.

Chapter 2

ALASKA'S WITHDRAWAL: A NEW ATTITUDE IN THE SOCIAL SECURITY ADMINISTRATION

On January 1, 1980, in the single largest termination to date, Alaska became the first State in history to terminate social security coverage for all its State employees. This much-publicized event has been viewed as a symbol of a lack of confidence in the social security system, and many supporters of social security, both within and outside the Social Security Administration (SSA), fear that it may have a ripplelike effect, influencing other State and local groups to withdraw from the program. Others maintain that Alaska is unique, and that there may be some question of the applicability of Alaska's decision to other States.

Alaska is indeed unique. In addition to its geographic uniqueness (it is the largest in area and northernmost State) it ranks highest in average pay and has the youngest and most transient work force. Nevertheless, the issues raised by Alaska's withdrawal and the events surrounding it were significant enough to spur a change in the way SSA reacts to pending terminations.

Background

The sequence of events leading to Alaska's withdrawal from the system began in 1975 with the approval of a union contract calling for a study to be undertaken by the State. The purpose of that study was to examine the desirability of continuing social security coverage for State employees. At the same time, the State sent notice to the Secretary of Health and Human Services (HHS) (formerly HEW), requesting termination of Alaska's social security coverage, to be effective January 1, 1978. The notice of termination was submitted so that if the study showed that social security coverage was no longer desirable, there would not be a full 2-year waiting period left to serve after completion of the study.

At the time, Alaska's notice of intent to withdraw all State employees from social security coverage was the single largest notice of termination ever received. Naturally, it raised much concern within SSA. However, the agency lacked a well-formed policy regarding the way it responded to possible withdrawals and, although it was concerned about the trend toward increasing numbers of terminations, had traditionally been a passive observer of the termination process. It was considered somehow inappropriate for SSA to lobby on behalf of its own program. The result was an agency position of benign neglect. The Administration believed that the social security program was clearly superior to other retirement plans, and that this would, hopefully, become clear to Alaska's employees.

This combination of concern coupled with a traditional passive role created an atmosphere of frustration within the agency. When a letter was drafted to the Governor of Alaska expressing concern over the possible effects termination could have on present and future employees and their families, and listing several issues to be considered before any decision to termination was finalized, this was considered a breach of traditional policy. A considerably weakened version of the letter was actually sent.

In July 1977, Alaska withdrew its notice to terminate, primarily as a result of the conclusions of the study it had undertaken. That study, performed by William Mercer, indicated that duplicating the package of benefits available under social security would cost 22 percent of wages (as compared to approximately 12 percent—about 6 percent each for the employer and employee—under social security), and that a substitute plan would be difficult and expensive to administer. It appeared then that SSA's aloof posture would have no ill consequences. However, only a few months later, Alaska undertook a second study of the desirability of social security coverage.

When interviewed by the committee, Alaska's Commissioner of Administration, Bill Hudson, stated that the employees demanded this second study, since the majority were intent on leaving the social security program and were therefore dissatisfied with the results of the first analysis. Unlike the first study, however, the new one was designed to examine alternate kinds of protection that might be more desirable to the State employees, rather than attempting to develop a State system to duplicate social security protection. Around the time the new analysis was begun, a second notice of termination, to be effective January 1, 1980, was sent to SSA.

Mr. Hudson was quick to point out that the State did not push the idea to terminate and tried to present both sides of the argument. Mr. Hudson told the committee that it is common knowledge that "only social security can do it all." However, he went on to point out that it was clear that many employees were determined to leave the social security program regardless of the kind of protection that would be offered to replace social security. The Commissioner attributed this determination to several factors. First, he stated there was a great frustration with the lack of information about the social security program. Specifically, there was unease about how the social security contributions were being spent and a concern that the system was being "watered down" by welfare payments. There was also much disgruntlement with the rising cost of the program and worry over its long-term solvency. Just as significant, or even more so, in the eyes of Mr. Hudson, however, was the sentiment within Alaska against the Federal Government as a whole. According to Mr. Hudson, there was some carryover resentment against other unrelated Federal activities (such as the Alaska lands bill) that influenced the vote against social security. And there was also the feeling that the Federal Government was centered too far away to understand the needs of the people of Alaska.

Throughout the termination process, the only State employee group opposing withdrawal from the security program was the Public Employees Local No. 71 of the AFL–CIO. According to Jim Younger, assistant business manager of the local, the union's primary concern

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was that the State did not have a viable plan for replacing social security. Especially disconcerting to the union management was the fact that employees were being asked to make a choice between social security and a replacement plan before the replacement plan had been finalized. Thus, there was no way for the employees to know exactly what would be offered to replace social security. Mr. Younger stated that in spite of this the employees "wanted out," and "the union leadership took a lot of heat" for the decision to lobby to remain in the social security program.

The Social Security Administration declined a role in Alaska's decisionmaking process, and for nearly 3 years, took no action. Finally, in August of 1979, one SSA representative was sent to cover the entire State of Alaska with only a few weeks left before the final decision. By then, it was acknowledged that SSA had done too little too late to affect the outcome of the vote.

The AFL–CIO representative confirmed that more involvement on the part of SSA might have prevented the termination. As it was, though, Mr. Younger feels that the representative from SSA did more harm than good since he seemed reluctant to lobby in favor of the social security program. In Mr. Younger's opinion, the Social Security representative seemed "uncaring" about the situation. The committee suspects that this was a reflection of the ambivalent attitudes and confused policy within the agency itself.

The Vote

Although the State government could have terminated social security coverage for its employees without a vote, it chose to resolve this controversial issue on the basis of employee preference. A State law enacted in May 1979 provided that the State would withdraw from social security only if a simple majority of the employees voting approved of the withdrawal. The vote was conducted by means of a mail-in ballot and, in discussion with the committee, Mr. Hudson and Mr. Younger concur that the State did a good job of distributing the ballots and explaining the importance of the vote.

By September 1979, the results of the vote were in. Of 14,451 State employees, less than 25 percent (3,357) voted to withdraw, 19 percent (2,475) voted to stay in, 4 percent submitted defective ballots, and over 50 percent did not vote at all. In the largest single termination to this date, all of Alaska's State employees—present and future—were irrevocably pulled out of social security by 25 percent of the current employees. Mr. Younger and Mr. Hudson attribute the low-voter response to voter apathy.

The question of whether more involvement on the part of Social Security would have changed the outcome of the vote in Alaska is one that can never be resolved with certainty. There seem to be arguments on both sides. Alaska is unique, and the unique characteristics of its employees indicate that, for them, there may be reasonable arguments against coverage. Workers in Alaska are, on average, highly paid and therefore receive a lower return on their social security contributions than do lower paid workers. In addition, Alaska's employees are younger than average and more transient. It is reasonable to assume that this young, transient group would have fewer depend-

ents and less immediate concern about retirement benefits. Moreover, they may believe that they will eventually leave their present position and obtain social security coverage elsewhere. In short, it is likely that this group would be interested in maximizing take-home pay at the expense of insurance protection. To support this assumption, Mr. Younger, of the AFL–CIO, informed the committee that many employees have expressed dissatisfaction with the withdrawal, complaining that they expected to be able to pocket the money that had been going to pay for social security coverage. Of course, this is not the case; an amount equivalent to the social security tax is now going to the new State plan.

Mr. Younger went on to say that, if the vote on social security were held today, the union leadership would probably still oppose termination. He stated that the State plan has created many administrative jobs within the State, but, all in all, "has probably not been in the best interest of the employees."

Mr. Hudson, on the other hand, feels that most employees are satisfied with the new arrangement, although he concluded that some employees have been disadvantaged by the withdrawal. These are employees who are very close to retirement and will lose some social security benefits, but will probably not continue working long enough to become eligible for benefits under the new system. Mr. Hudson emphasized that this problem only affects a small percentage of the State's employees but expressed regret over the "all or none" approach to the termination of coverage.

Alaska's New Plan

The plan adopted by Alaska to replace social security is called a "cafeteria plan" because it allows employees individually to select from among the following kinds of coverage supplementing the State's own basic employee benefits:

—Health care.
—Lump-sum death benefit.
—Disability income.
—Survivor income.
—Annuities.

Each employee is given the right periodically to change the kind of protection chosen from among these options.

The cost of the plan is 12.26 percent of pay up to the social security taxable wage base (6.13 percent each from the employee and the employer). This percentage is fixed, but the pay levels to which the percentage applies will increase to match increases in the social security wage base. While the tax rate for the replacement plan is equal to the 1979–80 tax rate paid under social security, it will be less than the social security tax rates scheduled for 1981 and later.

Social Security's New Role

Perhaps the most important outcome of the Alaska termination to the Nation as a whole is the change it precipitated within SSA. The withdrawal of Alaska marked a turning point in SSA policy. Since that time, the agency has pursued a new and vigorous approach

to informing the public of the advantages of social security. The Social Security Act is extremely complex and many Americans are understandably unaware of the full range of benefits available under the program. Thus, the social security program may not be seen as the value it really is.

It appears that the public perceives this more aggressive approach to disseminating information about the social security program as a legitimate function of SSA. In fact, reluctance on the part of Social Security representatives to speak on behalf of the program's good points is often interpreted to mean that there are none. Moreover, as Mr. Hudson and Mr. Younger both point out, many people are selling the idea to leave the social security program, but, until recently no one was presenting the other side of the issue. The committee heard this sentiment expressed by several groups in our survey who have terminated coverage in the past few years and were frustrated in their attempt to get information about the value of social security.

Alaska's commissioner of administration was quick to add that he feels that SSA has become much more effective in preventing withdrawals. Mr. Hudson told the committee that only a few months after the State employees had terminated coverage, he was invited to a seminar conducted by the SSA. According to an SSA representative, this seminar was conducted to discuss the value of the program and respond to questions in an effort to prevent a flood of withdrawals by the local government employee groups within Alaska. So far, this effort has been successful.

While it is probably too early to assess the effectiveness of SSA's new efforts, there is cause to be optimistic. In the short time since these efforts were begun, several terminations that would have affected large numbers of employees have been prevented, at least in part because of this new responsiveness on the part of the Administration. Even more important, the public seems to accept, in fact welcome, the Social Security Administration's new role in the termination decision.

Chapter 3

THE SURVEY

Background

To obtain information on what prompts some State and local groups to consider terminating social security coverage, the committee surveyed 55 State and local groups nationwide. Each of the groups surveyed fell into one of three categories: (1) *Category I*—groups that have terminated their social security coverage in the recent past (generally in 1977); (2) *category II*—groups that submitted a notice to terminate coverage but rescinded that notice; and (3) *category III*—groups scheduled to terminate their social security coverage in the near future (1981–82).

The groups surveyed were asked to respond to a detailed questionnaire [1] designed to establish, among other things: (1) Why the group considered withdrawing from the social security program; (2) where that idea originated; (3) why some groups rescinded the notice to terminate coverage; (4) general characteristics of the group and its employees; (5) what information was used to evaluate the termination decision; and (6) whether any program would be offered to replace the lost social security protection.

In general, the groups surveyed were chosen at random. However, 15 groups contacted by the committee in 1976, for an earlier working paper [2] on this issue, were recontacted for this survey to learn how many groups did, in fact, withdraw from the program, and what the experience of the groups has been over the past 4 years. These 15 groups represent a 10-percent random sample of the 150 groups that had termination notices pending in 1976.

Fifteen groups were selected at random from among all the groups that have rescinded a notice of termination over the past 3 years. These groups were surveyed to learn why the notice of termination was withdrawn, and how these groups compare with the groups that have actually terminated social security coverage.

Finally, the committee randomly selected 25 groups, with termination requests currently pending, to compare with both other categories of groups. These 25 groups represent a 10-percent sample of the 250 groups that had termination notices pending as of January 1, 1980.

While the data in this report is meant to be representative of State and local groups nationwide, the conclusions derived here are not necessarily those that would have been reached if all the groups that have filed a notice to terminate in the past several years had been surveyed. However, the committee believes that the data is representative enough to establish trends, and can be used to broaden our under-

[1] A copy of the questionnaire is reprinted in appendix 1.
[2] "Termination of Social Security Coverage: The Impact on State and Local Government Employees," September 1976.

standing of the way in which decisions about social security coverage are made.

The committee wishes to thank the State and local groups who provided the data presented here. In all, 38 groups, or approximately 70 percent of the 55 groups surveyed, answered all or part of the committee's questionnaire. Appendix 2 presents the major portion of the data collected in chart form.

While most groups did an excellent job of responding, the data reflects the fact that several groups failed to furnish some of the information requested. In some cases, this apparent inability to provide the information is quite understandable, since certain data that was requested (such as average age and length-of-service of the employees in the group) might not be readily obtainable. However, the committee is concerned about the apparent lack of knowledge of some important issues. For instance, most groups were apparently unable to provide the committee with detailed information on the kind of program that would replace social security. This is particularly disturbing since the person responding to the questionnaire was, in many cases, the individual in charge of employee benefits.

Generally, in the course of analyzing the data, the responses of groups in category I (those which have recently withdrawn from social security) are compared with the responses from groups in category II (those which have recently decided to remain in the program). Since the groups in category III are a mix of those that will actually terminate coverage and those that will choose to remain in the program, the data here is less conclusive.

The committee has attempted to present the data in the most concise and telling manner possible. Since this discussion is quite lengthy, a summary of the important findings is presented at the end of this section.

The Data

DEMOGRAPHICS

The 55 groups surveyed were selected at random from groups who are currently considering termination of social security coverage or have recently done so. The groups range in size from 2 to 11,725 employees. While they represent every region of the country, there are a disproportionate number of groups located in California and the Southern States, since there is more termination activity in these areas. Many kinds of workers are employed by these groups, including schoolteachers, transportation workers, firefighters, and local government administrators.

The detailed demographical information requested from each group includes: (1) Average salary level; (2) average age and length of service; and (3) number of employees in the group. The primary purpose of this information is to determine whether employees of groups that actually terminate social security coverage are, on average, significantly different from employees of groups that decide not to leave the program.

AVERAGE SALARY

There is a popular assumption that employees with higher salaries are more likely to terminate social security coverage than employees with relatively low salaries. This would appear to be a logical hy-

pothesis since the social security benefit formula is "weighted" so that individuals with lower income receive a higher return on their social security contributions than individuals who earn higher salaries (as explained in chapter 8).

The results of our survey do support this assumption, but only to a degree. The data shows that, while 64 percent of the groups that have decided to remain under social security have average wage levels below $15,000, only 50 percent of the groups responding that have recently terminated social security coverage have average wage levels below this amount. This does not appear to be a convincing pattern, however. For instance, among groups in categories I and II, the only group with average salary above $20,000 has opted to remain in the program. This group stated that a majority of its employees see social security as better protection than any alternate plan. It is worth noting that this was one of only three groups surveyed that employed a private actuary to study the issue of termination.

Adding to the uncertainty of using salary levels as an indicator of the likelihood of termination for any particular group, is the fact that three groups in category III have average wage levels below $10,000. While it is possible that these groups may not actually leave the social security program, the employees in two of these groups have already voted to terminate coverage, primarily because they believe they can obtain better protection for the same cost elsewhere. This may reflect the fact that, although social security may be a superior value for low-wage earners, these workers probably have the greatest need to maximize take-home pay. It should be remembered that, although the social security benefit formula is weighted to favor workers with low earnings, the social security tax is regressive—people with low earnings pay the same percentage of their income as employees with higher salaries (up to the maximum amount of wages subject to the tax).

The third group in category III with average wages below $10,000 presents an interesting and disturbing case that illustrates the kind of problems that can occur under the voluntary nature of social security coverage for State and local workers. This group of 83 employees is being forced to leave the social security system because the State has refused to continue paying the employer portion of the social security tax, and the local system is not able to absorb this cost. This is a particularly unfortunate event for this group in light of the low average salary and the fact that the average age of the employee population is over 51. Worse yet, the only insurance plan these employees will be covered by once social security is dropped is a teachers retirement system to which the employer makes no contribution, and under which cost-of-living adjustments in benefits are made only when the State legislature approves them.

It is apparent that, in this case, social security protection is being terminated as a money-saving device for the employer at the expense of the employees. Although this is the only group that reported such a situation, the committee is quite concerned that State and local governments, being increasingly pressured to cut spending, will be tempted to eliminate vital protection for employees. Under the present law, of course, there is little recourse for the employees who are adversely affected.

AVERAGE AGE AND LENGTH OF SERVICE

Regarding average age and length of service, the committee found that the groups that have opted to remain in the social security program have a somewhat older population of employees, with a somewhat longer average length of service. It is not surprising that employees who have worked under the social security system for a longer period of time and are closer to retirement would be more likely to want to remain in the program. However, there were no striking differences in these parameters between the three categories of groups, and the overwhelming majority of groups in both categories report average employee age between 31 and 40, and average length of service as 6 to 10 years.

Length of service should not be discounted entirely as a parameter of what a group might do, however, since after 10 years of covered employment, workers have enough quarters of coverage to be eligible for social security retirement benefits, even if social security coverage is then terminated.[3] Thus, after 10 years of covered work, employees might be quite eager to terminate coverage.

NUMBER OF EMPLOYEES IN THE GROUP

One unexpected conclusion supported by the data is that large groups are apparently more likely to choose to remain in the program after the notice of termination has been given than are small groups.

The groups selected for this study range in size from 2 to 11,725 employees. Of the groups in category I—those that have already left the program—the average number of employees is 82.5. Of the groups in category II—those that withdrew their notice of termination—the average number of employees is 1,987—24 times the average size of groups in the first category. This surprising difference seems to be a real phenomenon; the averages do not appear to be skewed by a few very small groups in category I, or a few very large groups in category II. In fact, the largest employee population in the first category is smaller than all but four of the groups in the second category.

To verify that this size difference is not a result of sample selection, the committee determined the average size of all groups that have terminated social security coverage. This number is 185. Unfortunately, records on the number of employees in all groups that have rescinded notice of termination were not available. However, the average size of all groups with termination notices pending as of January 1980 is 335, almost twice the size of the groups already terminated. It seems reasonable to assume that this difference derives from the same phenomenon—namely that, of the groups with termination notices pending, the groups with relatively large numbers of employees will choose to remain in the program.

The committee believes there are at least two logical reasons that larger groups are more likely to withdraw a termination notice. Perhaps the simplest explanation is that, in smaller groups, there is probably a greater chance that a consensus about termination is reached before the notice is sent. Thus, small groups would probably not submit a request to terminate coverage unless the majority seemed to favor the

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[3] See question No. 8 in chapter 1 for an explanation of quarters of coverage.

idea. In larger groups, often with a more diverse employee population, it would be more difficult to gage the attitude toward termination. As an example, the committee found one group within category II, with 3,000 employees, that withdrew its notice of termination because a significant faction of employees objected to withdrawal. The group is made up of both certified teachers, eligible for benefits under the State teacher's retirement system, and classified employees who are ineligible for membership in that system. When a vote was held, a majority of the teachers, who had been the most vocal about the idea, voted to withdraw from social security, but 86 percent of the classified employees opposed termination, since social security is their only form of insurance protection. In this case the classified employees have retained social security coverage. However, it is obvious that there must be cases where the outcome is not as fortunate. This is another example of a serious problem with present law protection of State and local government employees.

A second possible explanation for the fact that large groups seem more likely to opt to remain covered is that large coverage groups probably have more resources with which to study the issue. It is simply too large a burden on a group of 10 or 20 employees to assign even one employee to work full time on such a project. Moreover, it would also be too heavy a burden for a small group to hire a private firm to do the analysis. The committee found that an actuarial analysis of benefits under social security and an alternate plan costs upwards of $7,000.

WHY IS OPTING OUT CONSIDERED?

The rising price tag of social security coverage and the concern over a perceived lack of long-term financial stability are by far the most often quoted reasons for considering opting out of social security. These concerns were the predominant ones in every category, with 28 groups citing one or both of these issues as primary reasons for sending a notice of termination. It is interesting to note, however, that groups with termination notices pending offered somewhat more precise and sophisticated reasons for terminating coverage than did the groups that terminated coverage only a few years ago. For example, groups with notices currently pending were more likely to explain that the employees are seeking a better investment for their money, rather than simply stating that social security costs too much.

Of course, there are other considerations that are somewhat more involved than cost or solvency of the program. One entity in category I explained the reasons for the decision to opt out as follows: Currently, the group is covered under social security and the State public employee retirement system (PERS). Benefits under the two systems are coordinated. Thus, employees pay a combined tax rate of nearly 14 percent of wages, yet upon retirement, the PERS benefit is reduced by a portion of the social security benefit. By leaving the social security program, employees will reduce their insurance tax burden by nearly 50 percent without losing eligibility for social security benefits, since almost all of the current employees have enough work credits to remain eligible for social security benefits upon retirement. Moreover, these employees will collect social security and PERS benefits under more favorable conditions, since, in this case, the PERS benefit

will no longer be offset to take account of receipt of social security benefits. (This will almost certainly lead to an eventual increase in the cost of the PERS.)

It is impossible to argue with the logic of terminating social security coverage for current employees in this group. The only negative effect the choice might have is that it may adversely affect new employees, since they will not obtain social security coverage and may be left with inadequate alternate protection. This can be particularly dangerous since benefits under the PERS may have been designed to be supplemented by social security.

Groups in category I listed a variety of other reasons for leaving the program. One group terminated social security coverage because many employees would be eligible for social security on their spouse's record and did not want to pay social security taxes on their own behalf.[4] Two groups stated that they were dropping social security in favor of the State PERS because of the earlier retirement age and more generous retirement benefits under the PERS. Another group in category I was merged with a larger political subdivision that is not covered by social security and had no option to continue social security coverage. This is another example of a situation that can arise under present law which can adversely affect State and local government workers.

Although a majority of groups in both categories cite cost and solvency of social security as their major concerns, groups in category II were even less divided about their reasons for considering termination than the groups in category I. Twelve groups in category II gave cost as the primary reason for considering termination of social security coverage. One group cited concern about the long-term solvency of the program as its only reason for submitting a notice of termination.

Another entity in category II considered termination because one faction of employees—police and firefighters—desired to leave social security, since they would be eligible for good employment-related insurance benefits even without social security protection, although the rest of the municipal workers would not. The group did not withdraw since the city felt that "while withdrawal may benefit some employees, employees for the most part would have been adversely affected," and the respondent stated that there was strong opposition to withdrawal from the majority of employees. Although it did not actually occur, this is another case in which many employees might have been disadvantaged because of the desires of one faction of workers within the group.

As in the other two categories, cost and solvency of the program are the primary concerns of the majority of groups in category III—those with notices of termination currently pending. Of these groups, seven stated that they have sent in a notice of termination because they are trying to develop a better investment.

Of course, as with the other two categories, there are groups in category III that expressed different reasons for terminating coverage. For instance, one group, discussed previously, wants to remain covered by social security, but cannot afford to because the State has refused to continue paying the employer's matching share of the social security tax. Another group cited, as primary reason for leaving social

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[4] Legislation recently enacted prevents this situation (refer to chapter 5).

security, the fact that employees in that group have relatively high salaries ($15,000 to $20,000) and "feel that they are paying benefits for those in lower income brackets." These employees believe they can obtain adequate protection at a lower cost from a different retirement plan. In a similar vein, one group in category III, citing cost and solvency as its main concerns about social security, went on to add that employees in the group view many social security benefits as welfare payments, and wish to end participation in the program because they oppose this "watering down of the social security program with welfare add ons."

WHERE DID THE IDEA TO OPT OUT ORIGINATE?

In order for the committee to gain more insight into the decision to terminate social security coverage, groups were asked whether the idea to end social security coverage originated with the employer or the employees. The responses showed an interesting pattern. Among groups in category I—groups that have withdrawn from the program—the idea to terminate coverage originated with the employees by a ratio of 2 to 1. However, in category II—the groups that chose not to leave the program—the idea to terminate coverage originated with the employer by a ratio of 3 to 1.

There are two explanations for this difference that seem most plausible to the committee. First, if the idea to terminate enjoys popular support with the employees, it is unlikely that the employer would prevent termination of social security coverage—particularly if it results in a savings to the employer. Thus, by the time notice of termination is sent, the decision may be a "fait-accompli." On the other hand, when the suggestion originates with the employer, it may be subject to more scrutiny and perhaps even suspicion.

Another explanation for the fact that, in category II, the idea to terminate coverage most often originated with the employer may be related to the finding that groups in this category are larger, on average, than the groups in category I. It should be kept in mind that a higher percentage of groups in category II cited cost concerns as the primary reason for considering withdrawal than in either of the other two categories. And with a large employee population, even a small per capita savings that the employer might realize under an alternate plan may be quite significant, even if the change would not be cost-effective at all with a small employee population. However, if savings to the employer is the motivation for considering termination, employees would likely be reluctant to approve such action.

WHAT INFORMATION WAS USED IN MAKING A DECISION?

In order to determine whether decisions about termination are made in a thoughtful manner, the questionnaire used in our survey contained a series of questions regarding the sources of information that were used in the decisionmaking process. Specifically, the survey asked whether or not the following three informational sources were used: (1) The Social Security Administration (SSA); (2) the State Social Security Administrator; and (3) other State and local government employee groups. The groups surveyed were also asked what

kind of information was sought from each source, and the impact the information had on the decisionmaking process.

The data indicates that almost all State and local groups contacted the Social Security Administration to discuss the possibility of termination. (This contact is *in addition* to filing a notice of intent to terminate coverage.) Since all categories of groups appear equally likely to contact SSA, it would appear that the Social Security Administration has little impact on a group's final decision. Moreover, all categories gave SSA high marks for helpfulness, with only one group stating that the SSA representative was not informative.

There are, however, some differences between categories I and II that become apparent from answers to succeeding questions. For instance, although contacting SSA is a near universal pattern, groups in category II are much more likely to have discussed termination with the State Social Security Administrator and other State and local groups, than are the groups in category I.

The differences between the two categories becomes even more apparent when one examines the kind of information sought. Groups in category II were much more likely to ask SSA and the State administrator specifically for reasons to remain covered. Furthermore, when contacting other State and local groups that had already terminated social security coverage, groups in category II were more likely to ask for general information on the group's experience, rather than for information on a narrower issue. This seems to support the hypothesis (presented earlier) that groups in category II are more likely to consider the termination issue very carefully.

Assessment of how the information received affected the decision to terminate also points up differences between categories I and II. Groups in the first category stated that the information had either no effect, or increased their desire to withdraw from the program. Only one group in this category stated that the information it received from outside sources convinced many employees not to terminate coverage, but not quite enough to prevent termination. (In this group, two votes were held. In the first, before any outside sources were contacted, the vote was 23–2 in favor of withdrawing. However, by the time the second vote was taken, after SSA, the State administrator and other State and local groups had been contacted, the vote had shifted to 17–16 in favor of termination—a margin of only one vote.)

Unlike groups in category I, the overwhelming majority of category II groups stated that the information they obtained from outside sources was instrumental in their decision not to withdraw from social security. While this may merely reflect the fact that the latter groups went out seeking different kinds of information, it may also indicate that these groups were less biased in evaluating segments to remain covered, or considered the outside sources to be more credible, than groups in category I.

WAS A STUDY DONE?

Our survey indicates that the majority of State and local groups do not conduct a formal study of the desirability of terminating social security coverage, and the overwhelming majority of the studies that

are undertaken are done "in-house" by members of the employee population. Only three groups in our survey hired a private actuarial firm for an analysis of the issue; two of these studies are not yet completed and the groups still have termination notices pending. The third study, already completed, was performed for a group in category II, by William Mercer, at a cost of $7,500. The group cited the major findings of the study as follows: "An alternate insurance plan would be more costly than social security, and difficult to administer." For this reason, the group withdrew its termination request.

The committee is sensitive to the fact that studies done by private firms are expensive, and many groups lack the resources to hire outside personnel. However, if it is at all possible, the committee urges groups to hire a reputable firm to do an actuarial analysis of the relative costs and benefits of social security and whatever alternate plan would be offered. If this is not possible, an in-house study is, of course, the next best option. However, the committee is concerned that the survey indicates that, in some cases, the in-house study was performed by the same person who had difficulty responding to key questions in the survey. It is quite apparent that these people lack the expertise to perform a study that may be the basis of the group's decision.

WERE EMPLOYEES ALLOWED TO VOTE?

The committee believes it is vital that employees be allowed to participate in the decision of whether or not to terminate social security coverage. Of course, knowing that employees in a particular group will be given the opportunity to vote does not allow one to predict with any certainty what the outcome of the vote will be, since employees in the majority of groups in every category were given the opportunity to vote.

The survey shows that, of groups in category I, every group responding to this question stated that the employees were given an opportunity to vote, and that the vote was in favor of terminating social security coverage. The major reasons given for the outcome of the vote are: (1) The cost of the program, (2) concern about its long-term financial stability, and (3) unfavorable media publicity regarding social security.

In category II, employees in 8 out of the 14 groups responding were allowed to vote, and voted against terminating coverage. Here the reason most often given for the outcome of the vote is that the employees believe that social security offers better protection than they would have received under an alternate plan. In one case, the fact that some employees are ineligible for benefits under a supplemental plan apparently led to rejection of the idea of terminating coverage. Interestingly, one group stated that its employees view social security as a necessary national policy, and this reason, along with the fact that social security coverage is "portable," was responsible for the vote to remain in the program.

Employees of six groups in category II were not given an opportunity to vote. The reasons for not conducting a vote varied widely. For example, one group learned that they could not leave social security without also leaving the Arizona public employee retirement system (PERS), so the idea was dropped without a vote. A group from

New York State learned that the State now prohibits withdrawal from social security, apparently in response to the fact that so many groups in that State were withdrawing from the program as a money-saving device (at that time, New York City was facing serious financial problems). In two other groups, a vote never came up because a supervisory board in each group determined that too many employees could be severely disadvantaged if the group withdrew, even if withdrawal was favored by a majority of employees. Finally, one group, which cited concern about the solvency of social security as its only reason for considering termination, rescinded its notice of termination shortly after Congress enacted legislation in 1977 to improve the financing of the social security program.

WHAT WILL REPLACE SOCIAL SECURITY?

In one section of the questionnaire, the committee elicited information regarding what, if any, insurance protection has been offered to replace social security. In general, this information, dealing with benefit structure and eligibility requirements under a new plan, was the most technical requested, and seemed to cause the most difficulty for the individuals responding. In fact, the majority of groups were apparently unable to provide enough information to allow for evaluation of protection offered by the plan. This is rather disconcerting since it probably indicates that many employees are unaware of the kind of retirement program they are opting for. Without this knowledge it is impossible to make an informed decision about the merits of continued social security coverage.

While most groups gave insufficient information to determine how their replacement plan compares with social security, six groups provided rather detailed information. From these six, one representative plan was selected, and an analysis of how the plan compares with social security was done. That analysis, along with guidelines to aid groups in doing their own comparisons is presented in chapters 6 and 7.

HOW IS THE PLAN FINANCED? ARE BENEFITS GUARANTEED?

A pension or insurance plan is worthless if one cannot rely on the fact that the benefits will be paid if the eligibility requirements are met. The committee has seen that well over half of all the groups surveyed listed the solvency of the social security program as one of their biggest concerns. There is a widespread fear—in some cases, a conviction—that the social security program will suffer financial collapse and will be unable to pay benefits. Yet, it is unthinkable that the Federal Government would turn its back on a program that helps to support one out of every seven Americans. Social security represents a trust between the American Government and its citizens. The committee can foresee no circumstance under which the Government would allow that trust to break down. Ironically many groups that cite concern about social security's possible inability to pay benefits, opt for a plan (administered at a State or local level) that runs a far higher risk of financial collapse.[5]

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[5] See chapter 5 for a discussion of this problem.

The survey shows that six groups are enrolled in plans that have little, if any, cash reserves. Under these so-called "pay as you go" plans, the plan collects only enough money to cover the benefits currently payable. Although this may be an appropriate way of financing the social security program, which is backed by 90 percent of the Nation's work force, it can be risky for a small plan. Moreover, of the groups responding, five state that benefits under the plan are not guaranteed by the employer. This is particularly disturbing in the case of the two groups in category I that have dropped social security coverage and are covered solely under a plan with a pay-as-you-go system of financing.

Three groups stated that the funds collected by the plan could be borrowed by the employer. Here, there may be a real danger of non-repayment of pension fund moneys.

It is both interesting and disconcerting to note that category I—groups that have opted out of the social security program—has the highest percentage by far of groups under a pay-as-you-go plan, as well as the highest percentage of plans where the benefits are not guaranteed by the employer. Perhaps this indicates that the groups in category I generally have a more casual attitude toward their future retirement plans, and for this reason, are less cautious in their decision to drop social security coverage.

ARE COST-OF-LIVING ADJUSTMENTS OFFERED UNDER THE REPLACEMENT PLAN?

One of the most important things to look at when choosing an insurance or annuity plan is whether or not adjustments are made for increases in the cost of living. Under social security, cash benefits are automatically increased each year to compensate fully for increases in the Consumer Price Index (CPI). There is no ceiling on the amount of the increase. Indeed, since 1975 alone, social security benefits have increased by over 60 percent. It is almost impossible for any smaller plan to match this aspect of social security. Yet many individuals seem to be unaware that social security benefits are adjusted automatically to keep up with increases in the CPI. In fact, when asked if the alternate plan the group has adopted or is currently considering keeps up with increases in the cost of living, two groups responded that "no program can do that." These individuals seem to be unaware that social security does exactly that.

It is interesting to note that, with one exception, every group in category I indicates that employees in the group are, for the most part, aware of the 14.3 percent cost-of-living increase in social security benefits effective June 1980, but that this knowledge would not affect the group's decision to terminate coverage if another vote were to be held today. The data from groups in category III—those with termination notices pending—indicates a similar pattern; most employees are aware of the increase in social security benefits, but this seems to have little impact on their desire to leave the program. Indeed, two groups in this category state that the 14.3 percent increase in benefits does not convince people to remain in social security, but instead adds to concern about the "runaway cost" of the program.

Of the groups in category I, four out of five indicate that the plan they are now under automatically adjusts benefits for inflation. However, all four have a maximum yearly increase of 2 to 3 percent. This is interesting because it may indicate that, at the time termination of social security coverage was being considered (1975–77 for these groups), the benefit adjustment provision under the replacement plan may have seemed adequate. Of course, in light of the current economic picture, these provisions seem far from adequate.

Six out of ten of the groups in category II that have a State or local retirement plan that supplements social security coverage indicate there is some benefit-adjustment provision under the supplementary plan. However, in three of these six plans, the benefits are adjusted on an ad hoc basis, rather than automatically. Moreover, the other three plans, which are adjusted automatically each year, each have a maximum adjustment of 2 to 3 percent.

Five out of eight groups in category III report that the plan they will most likely adopt if social security coverage is dropped is adjusted for increases in the cost of living, but here again four out of five have a cap of 2 to 3 percent on these increases.

Certainly, any group currently considering opting out of social security in order to join a plan that provides no cost-of-living adjustments in benefits, or places a limit on the amount of those adjustments, should study table 1 and charts 1 and 2 in chapter 5 of this report.

Summary of Major Findings

(1) The groups that have rescinded their notice of termination are significantly larger, on average, than groups that have actually terminated social security coverage.

(2) Surprisingly, the salary level of employees is *not* a good indicator of whether or not the employees will choose to terminate social security coverage.

(3) The committee found that the groups that have opted to remain in the social security program have a somewhat older population of employees, with a somewhat longer average length of service than the groups that have left the program. However, the majority of groups report average employee age between 31 and 40, and average length of service as 6 to 10 years.

(4) The rising cost of social security coverage and the concern over a perceived lack of long-term financial stability are by far the most often quoted reasons (in all categories of groups) for considering opting out of social security. However, groups with termination notices currently pending offered somewhat more precise and sophisticated reasons for terminating coverage than did the groups that terminated coverage only a few years ago.

(5) Among groups in category I—those that have withdrawn from the program—the idea to terminate coverage originated with the employees by a ratio of 2 to 1. However, in category II—groups that chose not to leave the program—the idea to terminate coverage originated with the employers by a ratio of 3 to 1.

(6) The data indicates that almost all groups contacted SSA to discuss the possibility of terminating social security coverage. More-

over, all categories gave SSA high marks for helpfulness with only one group stating that the SSA representative was not informative.

(7) Although contacting SSA is a near universal pattern in our survey, groups in category II are much more likely to have discussed termination with the State social security administrator and other State and local groups than are the groups in category I.

(8) Groups in category II were much more likely to ask SSA and the State social security administrator specifically for reasons to remain covered. Furthermore, when contacting other State and local groups that had already terminated social security coverage, groups in category II were more likely to ask for general information on the group's experience, rather than for information on a narrower issue.

(9) Assessment of how the information received affected the decision to terminate also points up differences between categories I and II. With only one exception, groups in the first category stated that the information had either no effect, or increased their desire to withdraw from the program. Unlike groups in category I, the overwhelming majority of category II groups stated that the information they obtained from outside sources was instrumental in their decision not to withdraw from social security.

(10) The survey indicates that the majority of State and local groups do not conduct a formal study of the desirability of terminating social security coverage, and the overwhelming majority of the studies that are undertaken are done "in-house" by members of the employee population. Only three groups in our survey hired a private actuarial firm for an analysis of the issue; two of these studies are not yet completed and the groups still have termination notices pending. The third study, already completed, was performed for a group in category II, and found that "an alternate insurance plan would be more costly than social security, and difficult to administer." For this reason, the group withdrew its termination request.

(11) Knowing that employees in a particular group will be given the opportunity to vote does not allow accurate prediction of what the group will choose to do, since employees in the majority of groups in every category were given the opportunity to vote.

(12) Requests for information regarding what, if any, insurance protection has been offered to replace social security seemed to cause the most difficulty for the individuals responding, and only six groups provided enough information to allow for evaluation of the alternate protection. From these six, one representative plan was selected, and an analysis of how the plan compares with social security was done. That analysis is presented in chapter 6.

(13) The survey shows that six groups are enrolled in pay-as-you-go plans (i.e., plans that have little, if any, cash reserves). Moreover, of the groups responding, five state that benefits under the plan are not guaranteed by the employer. Three groups stated that the funds collected by the plan could be borrowed by the employer. Category I—groups that have opted out of the social security program—has the highest percentage by far of groups under a pay-as-you-go plan, as well as the highest percentage of plans where the benefits are not guaranteed by the employer.

(14) With few exceptions, employees in every group are, for the most part, aware of the 14.3 percent cost-of-living increase in social security

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benefits effective June 1980, but this would reportedly have little influence on the group's decision to terminate coverage if another vote were to be held today.

(15) The majority of groups in every category indicate that the plan they have to replace or supplement social security protection has some cost-of-living benefit adjustment provision. However, the overwhelming majority of these plans have a limit on the adjustment (usually 2 to 3 percent per year), and many adjust benefits only on an ad hoc basis.

Chapter 4

A DOLLARS AND CENTS LOOK AT THE VALUE OF SOCIAL SECURITY

A judgment about the value of the social security program is central to the decision of whether or not to terminate participation in that program. Indeed, a decision to withdraw from the social security system implies that the program was examined and found to be lacking. However, this is often not the case. Chapter 3 cites evidence the committee found that the decision to terminate participation in the program is too often arrived at without thorough evaluation of the facts. Of course, this may not be the fault of the decisionmakers. The social security program is so complex and unwieldy a subject to study that even the most conscientious decisionmaker may be forced to make a judgment based on incomplete information.

To help alleviate this situation, the committee will attempt to present a clear discussion of the kinds of benefits payable under the social security program, and the value of these benefits. To aid in this endeavor, the committee has developed examples of the dollar value of each benefit, along with a fairly detailed discussion of the categories of persons eligible for the benefits.[1]

Most of the examples presented here are for workers who retire, become disabled, or die in 1980. Since all social security benefits are automatically adjusted for changes in the Consumer Price Index, the dollar value of benefits for workers who retire, become disabled, or die at some future date will be higher as the result of inflation.

For the most part, the examples show the monthly benefits that would be payable to workers and their dependents if the worker retires, becomes disabled, or dies in July 1980. Since the amount of benefits payable under social security is based on earnings, the examples show the benefits that would be payable for workers with: (1) Low earnings; (2) average earnings; and (3) earnings that represent the maximum earnings taxed under social security ($25,900 in 1980).

Each example assumes that the worker's entire career has been in employment covered by social security. Further, it is assumed that earnings increased as wage levels increased throughout the worker's career. Unless otherwise specified, the spouse is assumed to be the same age as the worker. Where the total amount paid into social security is shown, it is based on wages beginning with 1951. The amount does not include interest that could accumulate.

Note: Benefit amounts include the 14.3-percent increase effective in June 1980 (payable in July 1980).

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[1] Benefit amounts were provided by the Social Security Administration.

An Overview

One out of every seven Americans receives a monthly social security check. These checks replace a portion of the earnings that have been lost because of retirement, death, or disability of the worker. In addition to replacing lost earnings, the program provides medicare protection when people reach 65, have been disabled for 2 years, or have end-stage renal disease.

In all, social security currently pays nearly $13.5 billion in cash benefits and medicare payments each month. Most pension and insurance plans cannot provide the comprehensive protection offered under social security. Some may offer disability insurance or old-age and surviors insurance, or health insurance, but may pay limited benefits or have special restrictions on how long payments can be made or who can get them.

The amount of social security benefits an eligible worker and his or her dependents receives is based on earnings in social security covered employment from 1951 (or the year in which the worker reaches age 21, if later) up to the year the worker reaches age 62, becomes disabled, or dies. However, since wage levels are much higher now than they were in the past, past earnings are indexed, or updated, so that they are comparable to wage levels just prior to the worker's retirement, disability, or death. Then a monthly average of the indexed wages is computed. A formula is then applied to this average indexed monthly earnings amount, to arrive at the worker's primary insurance amount (PIA)—the basic amount from which all benefits are computed. In general, the worker's disability or retirement benefits is equal to the PIA, unless the worker opts to take reduced retirement benefits—available as early as age 62—rather than waiting for full retirement benefits, payable at age 65. Survivors and dependents benefits are a percentage of the worker's PIA.

The following discussion of the kinds of protection offered by the social security program is divided into four major parts: (1) Survivors insurance; (2) disability insurance; (3) medicare (hospital and supplementary) insurance; and (4) retirement insurance.

SURVIVORS INSURANCE PROTECTION

The loss of a loved one can be devastating to the survivors in many ways. To ease the financial loss, monthly social security benefits are paid to the eligible survivors of an insured worker. The following is a list of the categories of survivors who would be eligible for social security survivor benefits:

—Unmarried children under age 18 or under age 22 if full-time students.
—Unmarried children aged 18 or over who were severely disabled before age 22 and continue to be disabled.
—Widow or widower aged 60 or older.
—Widow, widower, or surviving divorced spouse if caring for the worker's child if the child is under age 18 or disabled. (The child, of course, also receives an insurance benefit.)
—Widow or widower aged 50 or older who becomes disabled not later than 7 years after the worker's death or within 7 years after the

widow or widower stops receiving checks as a surviving spouse caring for the worker's children.

—Disabled divorced widow aged 50 or older if the marriage lasted as least 10 consecutive years and if she becomes disabled within the 7-year period described above for disabled widows.

—Dependent parents aged 62 and older.

—Divorced spouse aged 60 or older if the marriage lasted at least 10 consecutive years.

—Grandchildren who were living with and dependent on the worker, and whose parents are disabled or deceased.

The scope of the social security program is reflected in the fact that 95 out of 100 children under the age of 18 have survivorship protection—that is, one or both of their parents are insured under social security. The average survivor's benefit for widows with two children was $767 in July 1980.

Examples

The value of social security survivors' protection for a family with young children depends largely on the number and age of the children, and the earnings of the worker. *For a young worker who has always had average earnings (about $11,440 annually in 1979) and who dies in 1980 leaving a spouse aged 32 and two children aged 3 and 5, the present value of social security benefits that will be paid to that family over the years—assuming that the children attend school until they reach age 22—is $124,000, and this is guaranteed inflation-proof.*

Monthly Survivor Benefits

Worker died in July 1980 at age 35, benefits beginning July 1980 [1]

Example 1. 1979 earnings $5,721 or $477 a month (low earnings):	
No survivors	-------
Spouse only [2]	-------
Spouse and 2 children	$445.80
Example 2. 1979 earnings $11,442 or $954 a month (average earnings):	
No survivors	-------
Spouse only [2]	-------
Spouse and 2 children	$826.60
Example 3. 1979 earnings $22,900 or $1,908 a month (maximum earnings):	
No survivors	-------
Spouse only [2]	-------
Spouse and 2 children	$1,061.90

Note: A $255 lump sum death benefit is payable in each case.

[1] Includes benefit increase that was effective June 1980.
[2] A spouse is eligible for reduced widow or widower's benefits at age 60, or as early as age 50, if disabled.

DISABILITY INSURANCE PROTECTION

Disability protection is another important part of the social security program. Significantly, it is a form of protection that is lacking in many other insurance plans. Even when disability insurance is offered, there are often provisos that the benefits are payable for only a limited period of time.

Four out of five adults have disability protection under social security in the event of the breadwinner's long-term disability, either as insured workers or as dependents of insured workers. Disability benefits are payable to insured workers and the worker's:

—Unmarried children under age 18—or under age 22 if full-time students.
—Unmarried children aged 18 or over who were severely disabled before 22 and continue to be disabled.
—Spouse age 62 or older.
—Spouse under age 62 who cares for the worker's child if the child is under age 18 or disabled and receives a benefit based on the disabled worker's earnings.
—Former spouse age 62 or older if the marriage lasted at least 10 consecutive years.
—Grandchildren who are living with and dependent on the worker and whose parents are disabled or deceased.

The average monthly benefit paid to all disabled workers is $370; the average monthly benefit paid to all disabled workers with a wife and one or more children is $729. These figures are based on benefits payable as of July 1980. As with all other social security benefits, disability insurance benefits are fully adjusted for inflation.

Examples

For a worker who becomes disabled in January 1980 at age 35, has a wife aged 32 and two children, aged 3 and 5, with average indexed monthly earnings of $888 and who dies after being disabled for 5 years, the value of benefits is $128,700. If the disabled worker in this example dies after being disabled for 20 years rather than 5 years, the present value of benefits is about $158,700. These dollar amounts include some survivors' benefits which would be payable in the event of the disabled worker's death. (While this example addresses the case of a disabled man, benefits would, of course, be payable to a disabled insured woman and her family, although the dollar value may be somewhat different, due to differences in actuarial assumptions about lifespan, likelihood of remarriage of the spouse, etc.)

Monthly Disability Benefits

Worker reached age 45 in January 1980, became disabled in January 1980, benefits beginning July 1980 [1]

Example 1. 1979 earnings $5,721 or $477 a month (low earnings):	
Worker only	$290.00
Worker, spouse [2] and 2 children	428.60
Example 2. 1979 earnings $11,442 or $954 a month (average earnings):	
Worker only	$451.60
Worker, spouse [2] and 2 children	677.40
Example 3. 1979 earnings $22,900 or $1,908 a month (maximum earnings):	
Worker only	$571.80
Worker, spouse [2] and 2 children	857.70

Note: The worker will be eligible for medicare after being entitled to disability checks for 24 months.

[1] Social security disability insurance benefits are payable after a 6-month waiting period. The amounts shown include benefit increase that was effective June 1980, and also reflect Public Law 96–265, the 1980 Social Security Amendments.
[2] Spouse's benefit will be payable only if spouse is caring for children also entitled to benefits; otherwise, no spouse's benefit will be payable until age 62.

MEDICARE INSURANCE PROTECTION

I. Part A: Hospital Insurance Protection

Medicare insurance protection is another valuable part of the comprehensive protection offered by social security. At age 65, workers and their dependents or survivors (also aged 65 or older) who are eligible for social security or railroad retirement benefits become eligible for part A (hospital insurance or HI) medicare. In addition, individuals under age 65 who have been entitled to social security or railroad retirement benefits for 24 months on the basis of a disability are also eligible for part A benefits, as are insured workers and their dependents who have end-stage renal disease. People 65 and over who are not eligible under any of these provisions can buy part A protection, currently at a cost of $78 a month, only if they also purchase part B (supplementary medical insurance, or SMI) medicare, currently at a cost of $9.60 per month. The cost of both parts of medicare is expected to rise again in July 1981.

Three types of care provided by participating organizations are covered under part A: (1) Inpatient hospital care, (2) posthospital extended care, and (3) posthospital home health services.

Inpatient hospital care is covered for up to 90 days in a benefit period. A benefit period starts when a person enters a hospital and ends when the patient has been out of a hospital or skilled nursing home for 60 consecutive days. Medicare currently pays all but the first $204 of the cost of covered services for the first 60 days. If hospitalization lasts longer than 60 days, the medicare beneficiary pays a $51 daily coinsurance charge for the next 30 days. In addition, a lifetime reserve of 60 days of inpatient hospital benefits is available to beneficiaries who have used up the 90 days of benefits in a benefit period. Here again, the patient must pay a $102 daily coinsurance charge.

Posthospital extended care is covered for up to 100 days in a benefit period if the care is begun shortly—generally within 30 days—after a hospital stay of at least 3 consecutive days. Medicare pays all covered costs for the first 20 days and, after the 20th day, pays all but $25.50 a day. The services covered are the skilled nursing or rehabilitation services provided daily to inpatients of skilled nursing facilities.

The third type of care covered by hospital insurance is posthospital home health services. Medicare pays for covered services in full. Up to 100 visits by nurses, physical therapists, and other health personnel are covered if furnished within 1 year after discharge from a hospital—after at least a 3-day stay—or from a covered stay in a skilled nursing facility.[2] A plan of home health care must be provided by a doctor.

Examples

It is difficult to assign a dollar amount to the value of medicare hospital insurance to an individual since this depends upon the state of an individual's health. However, some idea of the value of this insurance can be estimated based on averages. For fiscal year 1978, covered

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[2] Effective July 1, 1981, an unlimited number of visits by nurses, physical therapists, and other health personnel are covered if furnished within 1 year after discharge from a hospital or from a covered stay in a skilled nursing facility. Further, the 3-day stay requirement will be dropped effective July 1, 1981.

care in short-stay hospitals accounted for 95 percent of the total hospital benefits paid. The average short-stay hospital benefit was $1,687 and the average number of covered days of care for these stays was 10.7. Finally, the average lifetime value of hospital insurance benefits that can be expected to be paid for a couple, both reaching age 65 in 1980, is $43,000. Of course, all of these figure will rise in the future given a continuation of inflation.

Here is another way to illustrate the value of medicare's hospital insurance protection: 23.1 percent of the aged beneficiaries who received benefits for hospital services in 1977 received reimbursements between $1,000 and $2,000, and 25.3 percent received more than $3,000 in benefits. The following chart shows additional examples.

Reimbursement greater than:	*Percentage of aged beneficiaries*
$0	10.3
$300	19.5
$750	8.7
$1,000	23.1
$2,000	12.6
$3,000	12.8
$5,000	6.6
$7,500	5.9

II. Part B: Supplementary Medical Insurance Protection

Medicare's part B (supplementary medical insurance, or SMI) plan is unique in that, unlike the rest of social security, workers do not contribute toward medical insurance protection through a separate earmarked tax. People aged 65 and over—and people under age 65 who are eligible for part A (hospital insurance) medicare—who sign up for part B medicare pay monthly premiums for the protection. Currently this premium is $9.60 per month. Although the Government more than matches the amount of the premium to meet the full cost of the program (currently, the Government pays $23 per beneficiary per month), the cost of supplementary medical insurance is expected to rise in July 1981.

Under part B medicare, there is an annual deductible of $60. After the deductible is met, the plan pays 80 percent of the reasonable charge for covered services. Special limitations apply to psychiatric care and services of independently practicing physical therapists. Physicians' and surgeons' services are covered in the house, office, clinic, and hospital. Outpatient hospital services are covered if furnished by participating hospitals—or by nonparticipating hospitals for emergency outpatient services. In addition to paying the full reasonable charge for covered physicians' services (regardless of where performed), part B medicare now also pays for the overhead (or facility) cost of surgical procedures performed in ambulatory surgical centers or for surgery performed in a physician's office.

Part B benefits may be paid for up to 100 home health-care visits [3] in a calendar year when the service is provided by a participating home health agency. Since these benefits are in addition to those available

[3] Effective July 1, 1980, an unlimited number of home health care visits provided by a participating home health agency will be covered.

under part A, it is possible for a beneficiary of both plans to have reimbursement for more than 100 visits in a 1-year period. For example, an eligible beneficiary could receive up to 100 visits for a condition related to a prior inpatient stay and then receive 100 visits under part B for the same condition or for a condition which arose after the inpatient stay. The part B, or supplementary medical insurance plan pays the full amount, rather than 80 percent of reasonable cost, of home health services. No prior hospitalization is required.

Examples of other covered health services include outpatient physical therapy and speech pathology services, diagnostic tests, rental and purchase of durable medical equipment, and certain ambulance services.

Examples

As with medicare health insurance protection, the value of medicare supplementary medical insurance protection to an individual depends upon his or her health. The average benefit paid per bill was $59 in 1979. Over three-fourths of the medical insurance bills are paid for doctors' services, while more than 1 in 10 bills are for outpatient hospital services.

Here is another way to illustrate the value of medicare's part B protection: 11.7 percent of aged beneficiaries who received part B benefits in 1977 received reimbursements between $500 and $1,000, and 9.2 percent received more than $1,000 in benefits. The following chart shows additional examples of the value of medicare supplementary insurance to program enrollees:

Reimbursement greater than:	*Percentage of aged enrollees*
$0	39.1
$100	18.7
$200	10.1
$300	6.4
$400	4.5
$500	11.7
$1,000	4.7
$1,500	2.1
$2,000	2.4

RETIREMENT PROTECTION

The discussion of the value of social security retirement benefits has deliberately been left until last to underscore the fact that the social security program is much more than a retirement plan. In fact, only about 63 percent of all those receiving social security benefits are retired workers and their spouses.

Full social security retirement benefits are paid to eligible retired workers and their dependents when the worker reaches age 65. Reduced benefits are payable to eligible retired workers and their dependents as early as age 62. The same rules apply for dependents under both the disability and retirement programs.

About 94 percent of people aged 65 or over either receive social security retirement benefits or would receive them if they or their spouses were not working. By 1985, about 95 percent of the aged population will be eligible for benefits, and the proportion is expected to reach 98 percent by the year 2000.

Examples

For a worker who reaches age 65 and retires in January 1980, has a wife who reaches 62 in the same month, and has always had maximum covered earnings under social security, the lifetime value of social security benefits is $139,800. This figure includes the value of some survivor's protection for the wife, since the probability is that the worker will die before her. Once again, this protection is inflation-proof.

For people reaching age 65 and retiring in the future, the value of social security retirement benefits will, of course, be much higher. As an example, let's take the case of a worker and his wife who are aged 35 and 32, respectively, in 1980. Assuming the worker will retire in the year 2010, at the age of 65, the value of their social security retirement protection, including the wife's survivor protection, will be about $227,800, in 1980 dollars. This valuation is based on the actuarial assumptions included in the 1980 Report of the Board of Trustees of the Social Security Trust Funds. It further assumes that the worker will earn the maximum salary counted toward social security. That amount is $29,700 in 1981 and is expected to be about $47,400 in 2009 (the year before the worker in this example retires) in 1980 dollars.

Monthly Retirement Benefits

Age 65 in July 1980, retirement at the end of June 1980, benefits beginning July 1980

Example 1. 1979 earnings $5,721, or $477 a month (low earnings) :	
Worker only	$329.30
Worker and spouse	494.00
Total paid into social security by worker: $3,846.	
Example 2. 1979 earnings $11,442, or $954 a month (average earnings) :	
Worker only	$515.40
Worker and spouse	773.10
Total paid into social security by worker: $7,691.	
Example 3. 1979 earnings $22,900 or $1,908 a month (maximum earnings) :	
Worker only	$653.80
Worker and spouse	980.70
Total paid into social security by worker: $11,562.00.	

Note: The benefit amounts do not include the value of medicare available to the worker and spouse.

Monthly Retirement Benefits

Age 62 in July 1980,[1] retirement at end of June 1980, benefits beginning July 1980

Example 1. 1979 earnings $5,721 or $477 a month (low earnings) :	
Worker only	$232.60
Worker and spouse	341.70
Example 2. 1979 earnings $11,442 or $954 a month (average earnings) :	
Worker only	$361.60
Worker and spouse	531.10
Example 3. 1979 earnings $22,900 or $1,908 a month (maximum earnings) :	
Worker only	$460.40
Worker and spouse	676.20

Note: Medicare benefits will be available to the worker and spouse at age 65.

[1] Benefits are permanently reduced when the worker retires before age 65.

Estimates of Future Retirement Benefits

Worker and spouse now age 51 will reach age 65 in January 1994, retirement at end of 1993, benefits beginning January 1994 [1]

Example 1. 1993 earnings $18,940 or $1,578 a month (low earnings):

Worker only	$810.10
Worker and spouse	1,215.20

Total paid into social security by worker: $15,615.

Example 2. 1993 earnings $37,879 or $3,157 a month (average earnings):

Worker only	$1,264.90
Worker and spouse	1,897.40

Total paid into social security by worker: $31,230.

Example 3. 1993 earnings $84,900 or $7,075 a month (maximum earnings):

Worker only	$1,718.30
Worker and spouse	2,577.50

Total paid into social security by worker: $63,364.

[1] Benefit estimates based on the intermediate assumptions used in the 1980 Social Security Trustees' Report.

CHART 1

AVERAGE CASH BENEFITS

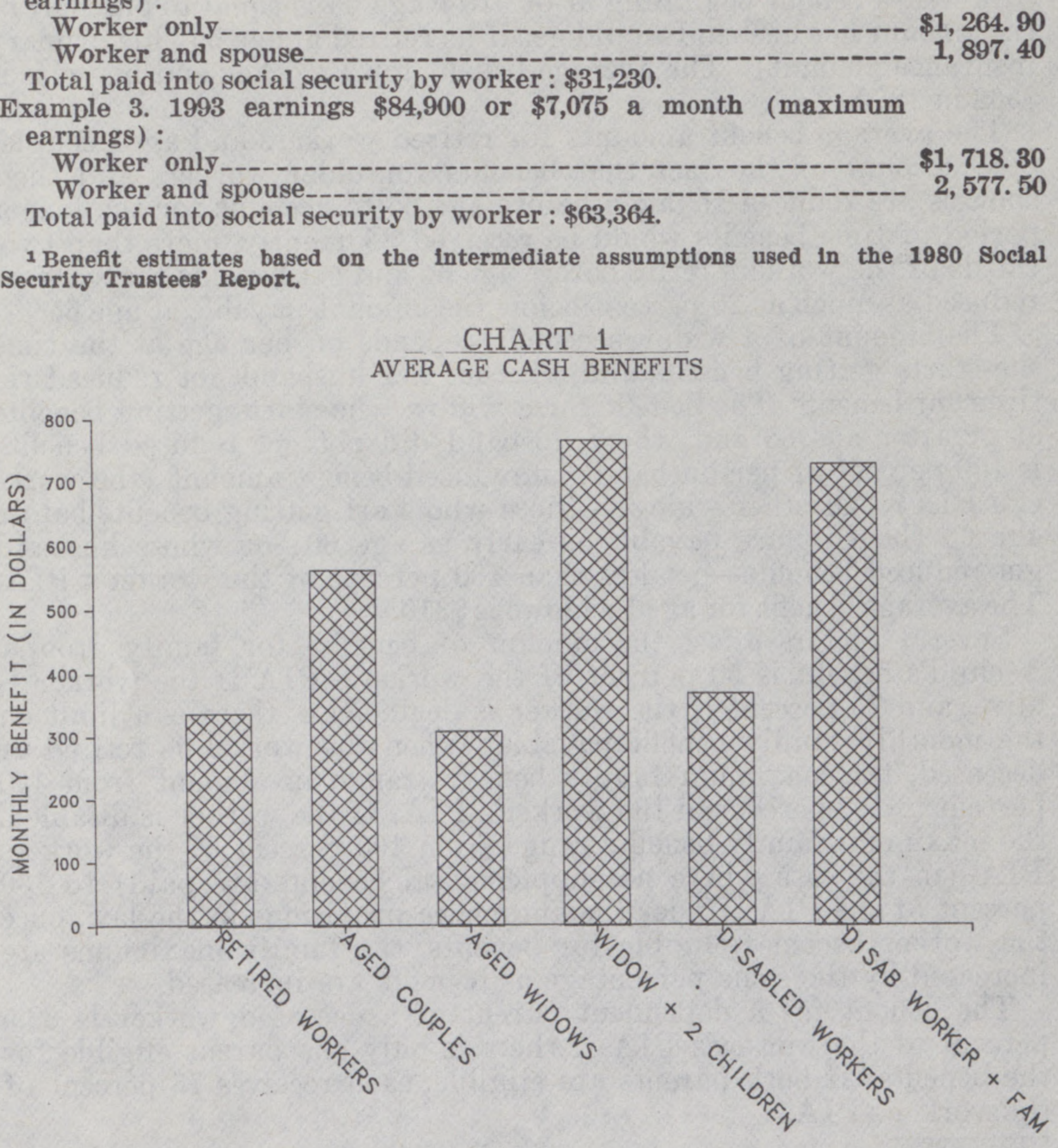

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Chart 1 shows average monthly benefits for some selected family groups.

The benefits paid to disabled workers do not ordinarily include reduced benefits, and greater continuity of recent earnings are required to be eligible for disability insurance benefits than for retirement benefits. This is at least a partial explanation for the fact that the average benefit for disabled workers is higher than the average benefit for retired workers—$370 as compared with $338 for July 1980.

A wife's benefit beginning at or after age 65 is equal to one-half of the amount her husband would get if he retired at age 65 (his primary insurance amount).[4] The average benefit for a worker and his wife is $562 in 1980.

The average benefit amounts for retired workers and aged couples take account of the fact that benefits for older workers and their spouses are reduced if taken before age 65 to account for the longer period of time benefits would be received. Currently, more than two-thirds of the workers retire before age 65 and get benefits that may be reduced as much as 20 percent below the amount payable at age 65.

The amount of a widow's benefit depends on her age at the time she starts getting benefits and whether her husband got reduced retirement benefits. The benefit for a widow who starts getting benefits at or after age 65 and whose husband did not get reduced benefits is 100 percent of her husband's unreduced benefit amount (the worker's PIA). All other widows—those who start getting benefits before age 65 (benefits are payable as early as age 60) or whose husband got reduced benefits—get less than 100 percent of the worker's PIA. The average benefit for aged widows is $310.

Several factors affect the amount of benefits for family groups. A child's benefit is 50 percent of the worker's PIA if the worker is alive, and 75 percent if the worker is dead. Also, there is a limit on the monthly family benefit payable. When the worker is retired or deceased, the maximum family benefits range in amount from 150 percent to 188 percent of the worker's PIA. If the worker is disabled, the maximum family benefits range from 100 percent of the workers PIA (in the case where no supplemental benefits are paid) to 150 percent of the PIA. Under the automatic provisions in the law, once the worker becomes eligible for benefits, the family maximums are increased by the same percentage as benefits are increased.

The benefit for a dependent parent of a deceased worker is 82.5 percent of the worker's PIA if there is only one parent eligible for the benefits; if both parents are eligible, each receives 75 percent of the worker's PIA.

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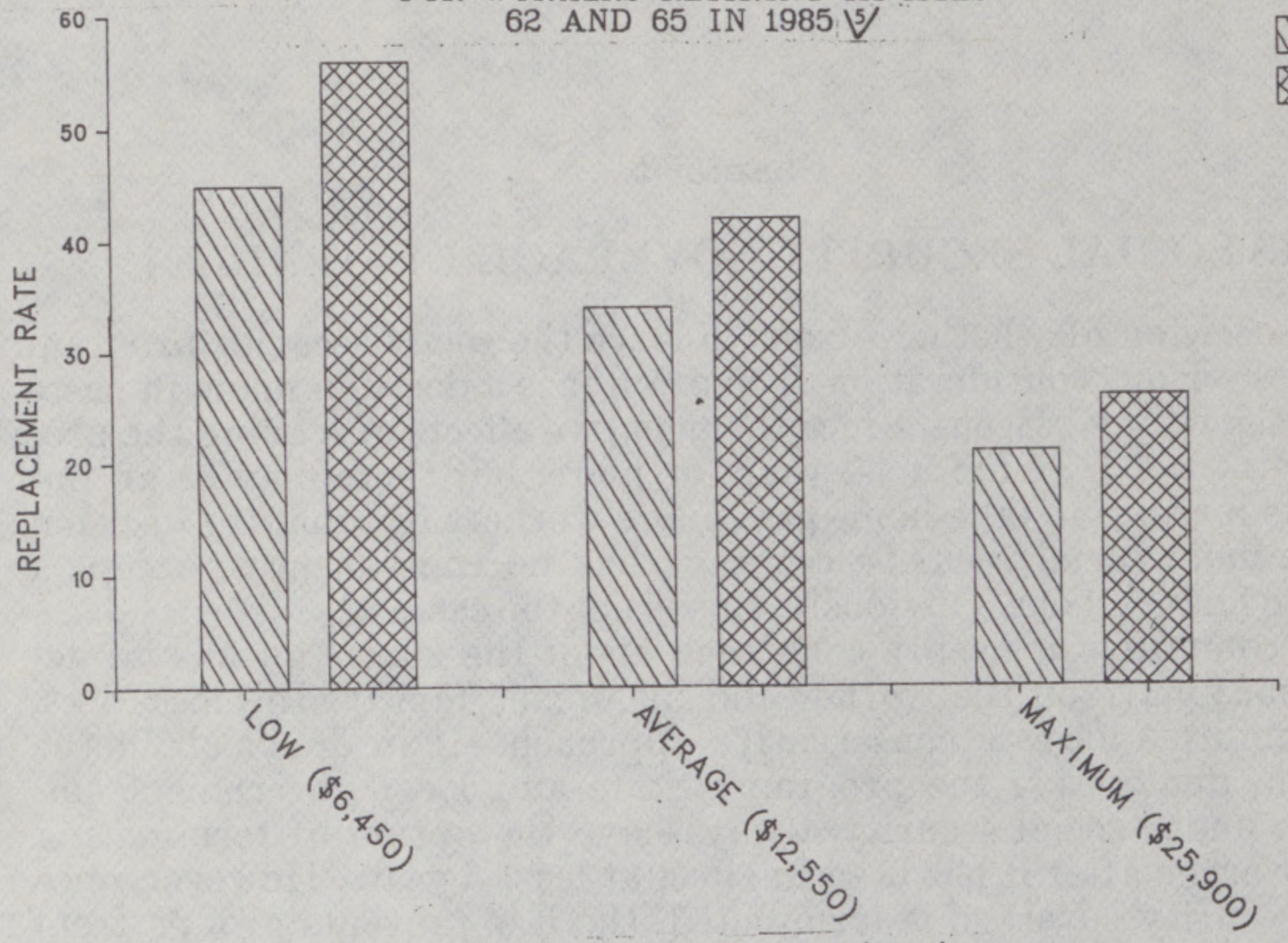
[4] See page 30 of this chapter for an explanation of primary insurance amount (PIA).

CHART 2. REPLACEMENT RATES
FOR WORKERS RETIRING AT AGES 62 AND 65 IN 1985 [5]



[5] Initial benefits as percent of final earnings.

[6] The wage levels for low and average earners are adjusted annually as general earnings levels rise. The maximum of $25,900 will increase to $29,700 in 1981 with automatic adjustments thereafter as earnings levels rise.

Chart 2 shows the replacement rates—the proportion of earnings that will be replaced by social security benefits—for workers at different earnings levels retiring at ages 62 and 65 in 1985 under the provisions of the 1977 Social Security Amendments. These replacement rates reflect the progressive nature of the benefit formula—the higher one's earnings, the lower the replacement rate. They also show replacement rates for workers who choose to retire before age 65 and collect actuarially reduced benefits.

Replacement rates are usually defined as the percentage of final year earnings that benefit amounts replace. If replacement rates are defined as a percentage of the average indexed monthly earnings (AIME [7]), the same progressive pattern for replacement rates would emerge but they would be generally higher. For example, all other things being equal, the initial benefits for the worker with career average pay, retiring at age 65 in 1985 would represent 57 percent of AIME compared with 41 percent of final year earnings. For the career maximum earner the initial benefit represents a replacement rate of 47 percent of AIME compared with 24 percent of final year earnings.

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[7] See page 30 of this chapter for an explanation of average indexed monthly earnings (AIME).

Chapter 5

IS SOCIAL SECURITY COVERAGE DESIRABLE?

The decision of whether or not to leave the social security program deserves serious consideration. Too often it is a decision made in haste or for the wrong reasons. Since the negative effects of leaving the program may not be felt for 30 years or more, but there may be an immediate increase in take-home pay, many workers feel that the decision to terminate social security coverage has no consequences, except a positive financial one. Obviously, this is not the case.

The committee is deeply concerned about the effects an unwise decision may have on the worker and his or her family. In most cases, the committee urges a conservative approach—if in doubt about the decision, don't leave the program; State and local government employees under social security always have the option of terminating that coverage after it has been in effect at least 5 years. However, once social security coverage is terminated, the law prevents groups from ever regaining that coverage.

In order to help State and local workers make a decision about social security coverage that is appropriate for them, we have divided the issue into arguments for and against social security coverage. Naturally, in any discussion about terminating social security coverage, one must evaluate the relative merits of social security and other plans. Since this is such a large topic, the committee has included, as separate sections of this paper, guidelines to help workers evaluate an alternate plan and a discussion of the value of social security protection (see chapters 4 and 7).

It is difficult to treat public employee retirement systems (PERS) as a group, since each system was established independently by an individual government for its own employees. However, the provisions of public employee retirement systems do display some patterns. Strong public employee unions have produced similar protection for most workers. Approximately 72 percent of State and local government employees are now covered by both a staff plan—that is, a pension plan sponsored at the State or local level—and the social security program. Almost half the workers belong to large general public employee retirement plans, and many other workers are concentrated in plans for teachers or public safety personnel (police and firefighters). These patterns of protection permit description of "typical" plans and their provisions.

In discussing the provisions of typical public plans, the committee has drawn heavily from the "Pension Task Force Report on Public Employee Retirement Systems," done by the U.S. House of Representatives, Committee on Education and Labor (95th Congress, second session) and "The Desirability and Feasibility of Social Security

Coverage for Employees of Federal, State, and Local Governments and Private Nonprofit Organizations," a report issued by the Universal Social Security Coverage Study Group in March 1980.

The Case for Social Security

VALUE OF SOCIAL SECURITY

Most of the important arguments for social security coverage derive from the value of the program. While a more complete discussion of the value of social security is contained elsewhere in this paper, this chapter is designed to define the ways in which social security is superior to most public employee retirement systems.

It is clear that the value of social security is often underestimated. A survey conducted by Peter D. Hart Research Associates, Inc., helps bear this out. That survey, of 1,549 individuals, done at the request of the National Commission on Social Security, was designed to produce an accurate cross section of the adult population of the United States at the present time.

Here are a few of the findings: "*Nine out of ten nonretired Americans expect to receive social security in retirement, and 60 percent expect it to be a major source of retirement income.*" However, the report also states that: "*Among those already retired, 75 percent find it to be a major source of income. Only among nonretirees with family income over $25,000 is social security overshadowed by other sources of expected retirement income.*"

It is interesting to note the difference in the percentage of nonretired Americans who expect social security to be of vital importance in retirement, and the percentage of Americans already retired who have found it to be a major source of income. While this is subject to varying interpretations, it may indicate that a sizable percentage of nonretired Americans underestimate the value social security will have during their retirement years.

For many Americans, retirement benefits are the only ones that come to mind in connection with the social security program. If the value of these benefits is underestimated, it follows that other aspects of the program, such as disability and health insurance, may be even less appreciated. In fact, many groups told the committee that they could "do better" by opting out of the social security program in order to join another plan, or by investing the same amount of money that would go to social security into private investments. Many voiced the opinion that both of these alternatives would allow them to obtain superior protection, or gain the same protection at a lower cost.

The committee questions both of these beliefs. As we have already seen, the value of social security protection is often underestimated. Furthermore, the administrative costs of the old-age, survivors and disability insurance, and medicare program are less than 2 percent (for fiscal year 1979). It would be difficult, if not impossible, for a smaller plan to match social security for value of the protection offered or cost of operation. An independent analysis of the cost of duplicating social security coverage for Alaska's State employees estimated it to be just over 22 percent of payroll. Further, the report, prepared in 1976 by William Mercer, stated the plan "would be extremely difficult

and expensive to administer." And there are several other examples of such findings in reports prepared by independent organizations. For example, the consulting firm of Towers, Perrin, Forster, & Crosby was hired by the commissioners of Dallas County, Tex., to examine the desirability of ending social security coverage for Dallas County employees. The following is a newspaper article on the firm's preliminary findings that appeared in the Dallas Morning News on October 22, 1980:

COMMISSIONERS FAVOR SS BENEFITS

After almost 2 years of investigating the plausibility of private pension plans, Dallas County commissioners probably will stick with Federal social security benefits for county employees.

The consulting firm of Towers, Perrin, Forster, & Crosby suggested Tuesday that the county forgo switching to a private firm for pension benefits.

"The bottom line is that our consultant told us it's going to cost more to replace social security, benefit by benefit," said Richard Lewis, the commissioners court administrator.

"They basically said that you can't reduce social security costs," he said.

Lewis said the commissioners court instructed him to prepare a letter to notify Social Security officials that the county will continue with the Federal program.

In March 1979, the county filed an intent to withdraw from social security in accordance with the law. The notice would not go into effect until December 1981.

That notice is expected to be rescinded at next Monday's regular commissioners court meeting.

The $20,000 consultant report indicated the county initially would save money by going to a private firm. But in 20 years, the county and its employees—who each pay half of the social security burden—would have to bear greater costs than if they were still under the Federal system.

The current social security program provides benefits to county employees who reach retirement age, payments to their survivors, disability allotments, medicare and built-in cost-of-living escalators that increase benefits automatically.

Some contend that they could do better by investing the same amount of money that would have been paid for social security in some private venture. Of course, it is possible that by retirement age such investments would yield more than social security. However, there are definite risks involved. Most laymen do not have the expertise to develop a sound investment portfolio. Moreover, since the money would not be automatically deducted from wages, there might be some temptation to use the money for current living expenses. A further consideration is that the value of the matching employer contribution might be sacrificed since the employer would not be required by law to match employee contributions under a private investment

plan. Finally, the scheme might be a disaster for individuals who become disabled or die shortly after starting this private investment plan, since there would not have been enough time to accumulate money into the account.

BENEFITS ARE TAX FREE

Adding to the intrinsic value of social security benefits is the fact that these benefits are not subject to Federal income tax. Most public pension system benefits are taxable once the employee's share of the contributions has been paid out.

PROTECTION AGAINST INFLATION

All social security benefits are guaranteed inflation-proof. The importance of this cannot be overstated, and it is virtually impossible for any non-Federal program to match this guarantee. In today's economy, this one feature of social security can outweigh many favorable features of another plan.

Social security is automatically and fully adjusted each year for the increase in the Consumer Price Index (CPI) when the CPI rises by at least 3 percent over a specified period of time. While almost all public pension plans provide for postretirement cost-of-living adjustments for annuitants, and more than a third of these plans have automatic increases linked to the CPI, these increases nearly always have an annual maximum of 1 to 5 percent and are clustered at 3 percent. The House of Representatives Pension Task Force has reported that less than 5 percent of State and local government employees are members of public employee retirement systems that have a full indexing provision. More than 60 percent of the public plans do not have automatic increases but do occasionally provide for ad hoc benefit increases that require administrative or legislative action. Furthermore, about half of all local plans, representing about 4 percent of State and local employees, have no provision at all for increases in benefits to retirees.[1]

After a period of time with inflation, a benefit that was originally more generous than social security may eventually be worth less than social security. In fact, a relatively low benefit with cost-of-living increases may be more valuable than a higher benefit that is not adjusted for inflation, as the following table indicates:

If the annual rate of inflation is:	*The following pension amount, adjusted for the cost of living, will provide a greater lifetime income than a flat benefit of $100 a month*
2.0 percent	$80
3.5 percent	65
5.0 percent	58
10.5 percent	32

The table below shows what happens to the real value of retirement income over a period of years at varying levels of inflation.

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[1] "Pension Task Force Report on Public Employee Retirement Systems"; Committee on Education and Labor, House of Representatives, 95th Congress, 2d session, Mar. 15, 1978, pp. 108–109.

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TABLE 1.—REAL VALUE OF RETIREMENT INCOME[1]

[Based on initial replacement rate of 100 percent]

	Annual inflation			
	No inflation	3 percent	5 percent	10 percent
Years in retirement:				
0	100	100	100	100
5	100	86	78	62
10	100	74	61	39
15	100	64	48	24
20	100	55	38	15
25	100	48	30	9

[1] Source: President's Commission on Pension Policy.

Keeping in mind that the average man retiring at age 65 will live approximately 15 years after retiring, it is disturbing to note that a fixed benefit will lose one-third of its purchasing power during his anticipated period of retirement at even a modest inflation rate of 3 percent. If the annual rate of inflation is 5 percent, a fixed benefit will lose over half its purchasing power during a 15-year period; and if inflation is 10 percent an unadjusted benefit will lose three-quarters of its purchasing power. Consider also that the average life expectancy of a woman retiring at age 65 is closer to 20 years than 15. Furthermore, many workers retire before age 65. Thus, the potential loss in buying power of an unadjusted benefit becomes greater for longer periods of retirement.

The following charts show what happens to benefit levels and buying power under retirement plans that have no cost-of-living adjustments, or a maximum cost-of-living adjustment of 2 percent yearly. In each case, the benefit levels and buying power can be compared with social security benefits. The inflation rates used are the ones predicted under the intermediate assumptions of the 1980 Social Security Trustees Report. The social security benefit increases (effective for June of each year) represent the increase in the average Consumer Price Index from the first calendar quarter of the previous year to the first calendar quarter of the current year.

CHART 1
THE EFFECT OF INFLATION
ON BUYING POWER

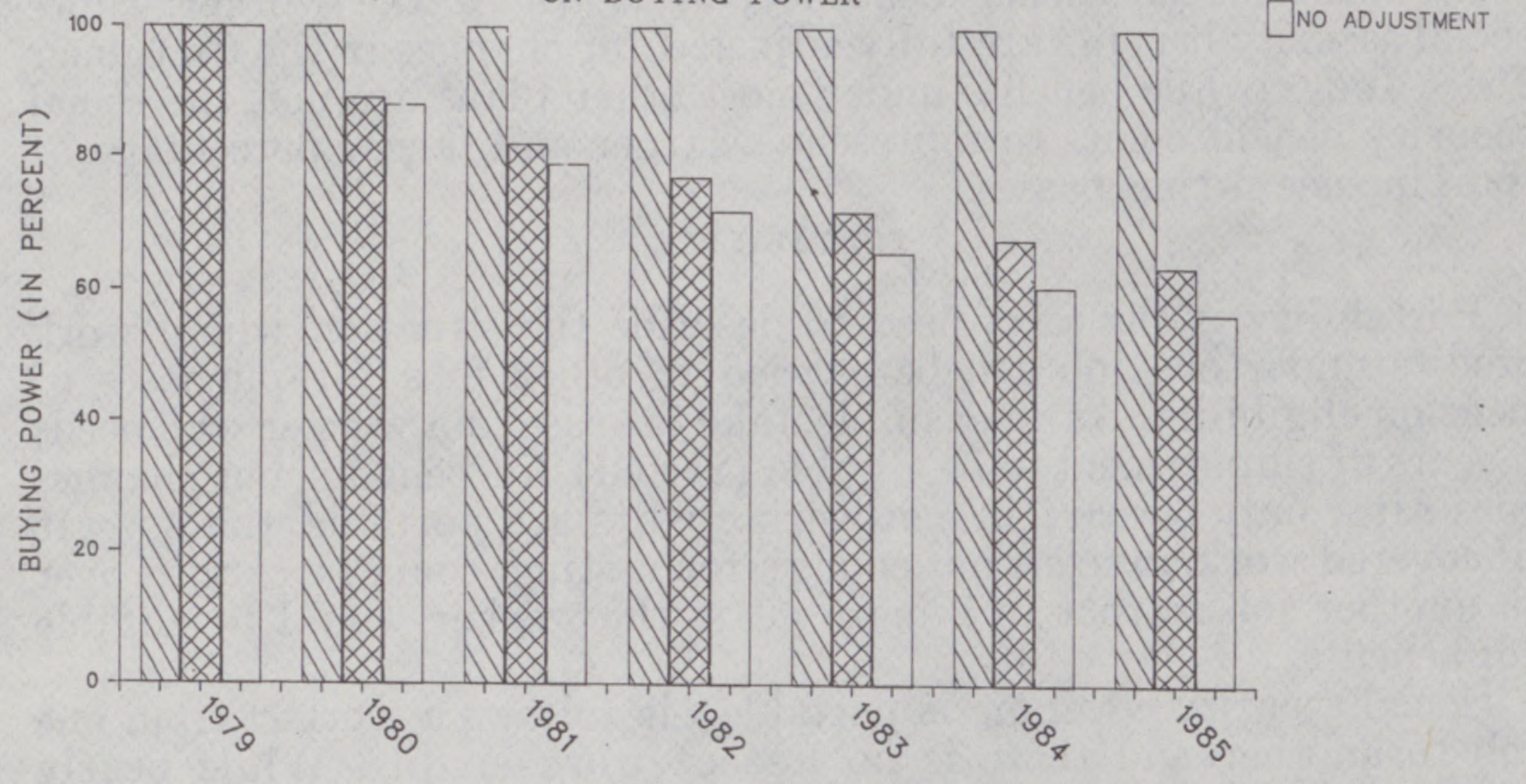
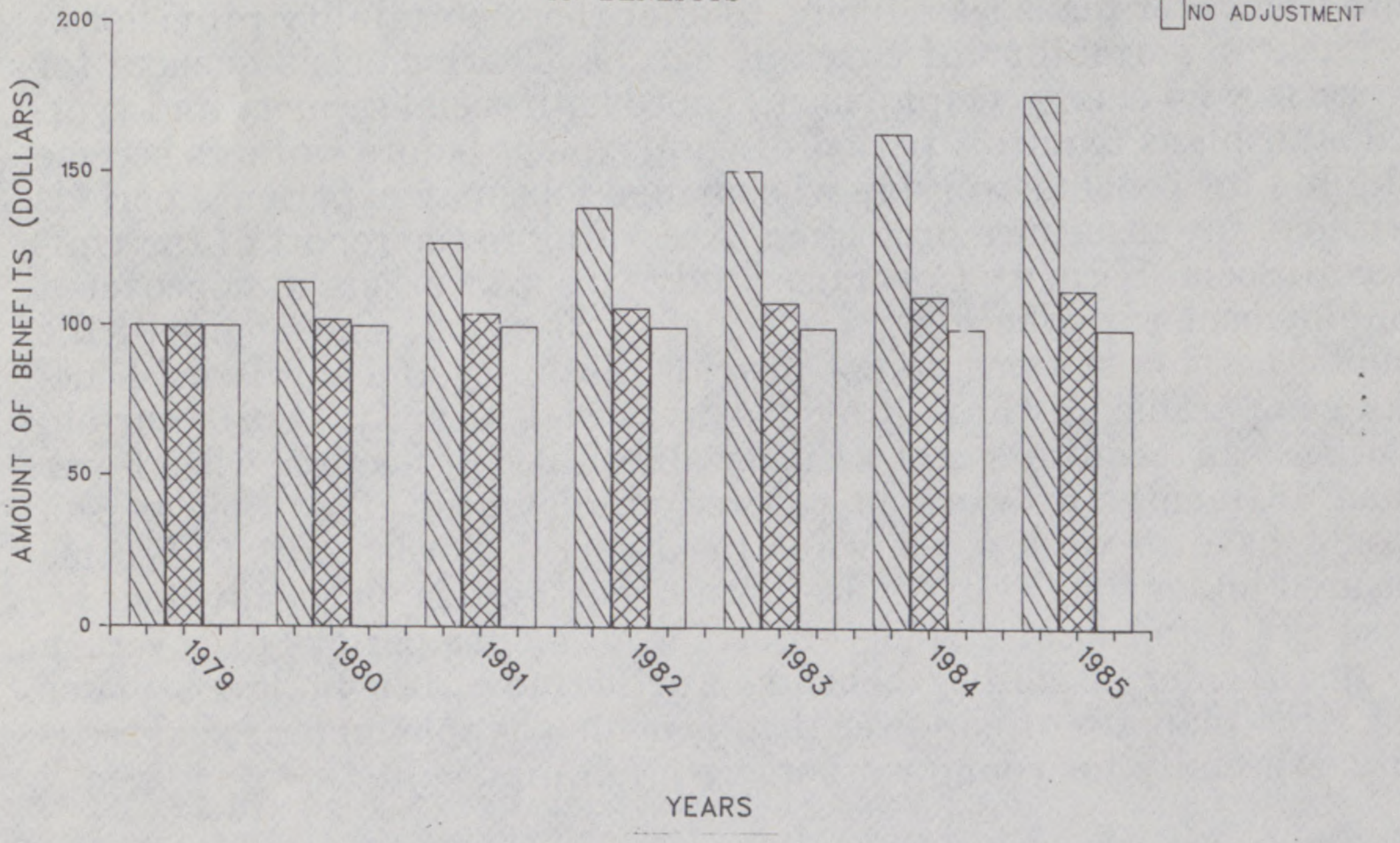


CHART 2
THE EFFECT OF INFLATION
ON BENEFITS



These charts attest to one of the major reasons that social security benefits become more and more important than other forms of protection after retirement, disability, or death of the worker. Since social security benefits are fully adjusted for changes in the Consumer Price Index while benefits under most other plans are not, the social security benefit comes to represent a larger and larger percentage of total income as time passes.

PORTABILITY

Portability is the term used to describe the situation where work credits under one job can be carried to other jobs for purposes of pension eligibility. As an example, take the case of a worker who needs 5 years of employment to be eligible (vested) for benefits, but changes jobs after only 3 years. When work credits are portable, the 3 years of covered work, in itself not enough for vesting, could be carried over to another job so that in 2 more years the worker would be eligible for benefits.

Social security coverage is portable—it follows a worker from one job to another and there is no loss of work credits. While nearly 82 percent of State and local employees are covered by a PERS plan that permits some form of intragovernmental portability, less than 10 percent of State and local employees are covered by retirement plans that permit portability for out-of-State service. Multiemployer plans and reciprocal agreements between plans within the same State provide more than 70 percent of State and local workers with limited, intrastate portability. The plans for teachers are most likely, and police and firefighter plans least likely, to offer these portability provisions.[2]

Lack of portability of coverage can have serious consequences for workers who change employment. Since both social security and typical staff plans require a period of employment before workers become eligible for benefits, workers who change jobs may experience periods without any insurance protection. According to the report of the Universal Social Security Coverage Study Group, workers in noncovered employment experience gaps in benefit protection, since many of the public pension systems do not provide disability and survivors' benefits comparable to those provided by social security. A 21-year-old worker can acquire social security disability protection with fewer than 18 months of work in covered employment. The same person would have to work 5 years for the Federal Government to become insured under the Civil Service Retirement System, but many noncovered State and local systems require even longer periods of coverage to qualify for disability benefits. Furthermore, benefit levels under a PERS plan are often lower than benefits payable under social security, especially for young workers with families.

DEPENDENTS AND SURVIVORS PROTECTION

The loss of income that occurs when a worker retires, becomes disabled or dies can be devastating to the worker's dependents or survivors. For this reason, social security provides benefits for various members of the worker's family. These benefits are generally superior

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[2] "Pension Task Force Report on Public Employee Retirement Systems"; Committee on Education and Labor, House of Representatives, 95th Congress, 2d session, Mar. 15, 1978, pp. 92–93.

to benefits offered under most PERS plans. For instance, while almost all public employee retirement systems provide benefits to survivors, only half of the plans provide annuities for widows and children. The other half of the plans provide that benefits to survivors of workers who die before retirement are either a refund of employee contributions plus interest or, if it is greater, a lump-sum survivor payment. When the worker dies after retirement, benefits for survivors are generally paid only when the employee's own retirement pension was reduced to pay for the survivor's protection.

The Universal Social Security Coverage Study Group report underscores the superior nature of survivor protection under social security:

> *Benefits to survivors of deceased workers:* Currently 7 percent of social security benefits are paid to children of deceased workers and the surviving widow or widower taking care of these children. This is a need-related benefit, based on family composition as well as on the worker's wages. *Particularly for young families, this benefit is likely to offer significantly greater protection than the provisions of the staff retirement system. Under the staff program, benefits may be very small because they are related to wages or to accrued retirement benefits with less adjustment for need.*
>
> *Benefits to survivors of deceased retirees: As previously indicated, benefits to surviving spouses of annuitants generally continue only if the annuitants' own benefits were reduced during retirement. Social security's widow or widower benefit is in addition to the full worker's benefit.* For the Nation as a whole, these benefits now add 20 percent to the total amount paid to retired workers; they amount to 13 percent of all social security outlays.[3]

DISABILITY PROTECTION

Nearly all public employees are covered under plans offering disability insurance protection. However, social security disability protection is unique in that it bases benefits on family composition as well as on the disabled worker's prior earnings. Benefits under most PERS plans are related only to salary and length of service. Thus, under a staff plan, disability insurance benefits for young workers can be quite low. For this reason, a minimum benefit of 25 to 33 percent of salary is often established.

Workers who are considering terminating their social security coverage should be aware that even if they are insured for social security benefits at the time participation in the program ends, disability protection under social security will end 5 years after termination, and sooner in some cases, because a certain amount of recent coverage is needed. Thus, even if the worker takes another job covered under social security, there will be a gap in disability protection of up to 5 years until the worker again has enough recent coverage to be insured for disability benefits.

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[3] "The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State, and Local Governments and Private, Nonprofit Organizations"; Report of the Universal Social Security Coverage Study Group, March 1980, pp. 215–216.

While many plans have a more liberal definition of disability than social security, the committee has found that some plans put a restriction on how long benefits are payable. For an individual with a severe impairment, 2, 3, or even 5 years of benefits will not be of help after the payments are discontinued if the disability persists. Under social security, on the other hand, there is no restriction on how long disability insurance benefits are paid—as long as the worker remains disabled and is under 65, the social security benefit is paid. (At age 65, social security disability benefit payments are discontinued, but social security retirement benefits—in the same amount—begin.) Additionally, social security benefits are paid to the worker's dependents to supplement the income to the family during the period when the worker is disabled. In the case of a young disabled person, disability insurance benefits may be paid for 30 or 40 years or more, and the worker's dependents are also protected.

MEDICARE

A major advantage of social security coverage is that at age 65, workers (and their dependents or survivors also aged 65) who are eligible for social security benefits also become eligible for part A (hospital insurance or HI) medicare. In addition, individuals under 65 who have been receiving social security benefits based on a disability for 24 months are eligible for part A medicare. People 65 and over who are ineligible for social security benefits can buy medicare protection only if they buy both parts of medicare, currently at a cost of $78 a month for part A, and $9.60 a month for part B (supplementary medical insurance or SMI) medicare. (These costs are expected to rise again in July 1981.) One major disadvantage to this, aside from cost, is the fact that no one under 65 may purchase medicare protection. Therefore, in the event of severe and long-lasting disability, a young worker would be without medicare protection and may have difficulty obtaining adequate protection at affordable cost from private health insurers.

RISK OF PUBLIC PENSION BENEFIT LOSS OR REDUCTION

Because social security is compulsory for most workers, the system is assured of a continuing income. Public employees covered by a State or local retirement system, however, may risk loss or reduction of benefits.

The Pension Task Force on Public Employee Retirement Systems had the following comments on the risk of loss of benefits under a public pension plan:

Unlike the situation prior to ERISA (Employee's Retirement Income Security Act) when private pension plan terminations resulted in widespread pension benefit losses, there is no conclusive evidence that widespread benefit losses have occurred as a result of public pension plan terminations.

However, survey information does show that nearly 6 percent of the existing public employee retirement systems were created after preexisting systems were disbanded. The extent to which the tax-qualified plans followed the Internal Reve-

nue Code requirement that accrued benefits under such terminated plans be vested to the extent funded is problematic. In the past the Internal Revenue Service has apparently followed a policy of nonenforcement in this area, and was, therefore, unable to supply any information in regard to public pension plan terminations.

The evidence shows that public employees do face the risk of pension benefit reductions or other benefit curtailments due to reasons other than plan termination. For example, 8 percent of the pension plans at Federal, State, and local levels covering 18 percent of the employees have been amended to reduce the value of past or future pension benefit accruals for active employees, while other plans have scaled back certain plan features for new employees only.

It appears that the greatest risk to public employees of having pension benefits reduced or other benefit features curtailed relates to governmental financial problems and the underfunding of public pension plans. Mismanagement, financing limitations, exceedingly high pension obligations, and financial emergencies have all contributed in the past to situations of pension plan insolvency or near insolvency. As a result of these situations, some public employees have suffered temporary and, in a few cases, permanent benefit reductions.

While nearly 69 percent of all State and local government employees are covered by pension plans subject to a constitutional or other legal provision prohibiting the diminishment or impairment of pension benefits, in many States the degree to which such provisions offer meaningful protection to public employee pension benefits remains unsettled. (Italics added.)[4]

REDUCTION OF SOCIAL SECURITY BENEFITS

Many State and local government employees who consider terminating social security coverage are reasonably comfortable with the idea because they are fully insured for social security benefits. However, as already stated, disability insurance protection is lost relatively rapidly. Moreover, there is also at least a partial loss of other social security benefits, even if the worker has enough work credits to be fully insured for retirement and survivors benefits, since benefits are based on average earnings over a working lifetime. For example, an individual aged 50 in 1979 who has average covered earnings through 1978, but no covered earnings from 1979 to age 65, would get an estimated monthly benefit of $1,068.30 at age 65. If, on the other hand, the worker had had average covered earnings until age 65, the estimated social security benefit would be $1,268.60.[5]

PENSION OFFSET FOR SPOUSES

Before the 1977 Social Security Amendments, a government retiree could receive, in full, both a public pension as a worker and a social security benefit as a spouse. Thus, many State and local government

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[4] "Pension Task Force Report on Public Employee Retirement Systems"; Committee on Education and Labor, House of Representatives, 95th Congress, 2d session, Mar. 15, 1978, pp. 101–102

[5] Benefit amounts calculated by the Social Security Administration.

workers chose to opt out of social security, thereby avoiding social security taxes, and get social security protection as a dependent based on their spouse's earnings under social security. However, opting out of social security for this reason may no longer be advantageous. The 1977 amendments provided for reducing the amount of a social security spouse's (or widow's or widower's) benefit by the amount of any pension the spouse may receive based on his or her own work in governmental employment not covered by social security. (Special provisions excepted some workers already retired or nearing retirement when the change was enacted. In general, married women, widows, men who were receiving at least one-half support from their wives, and divorced women who were married at least 20 years before the marriage ended, are exempt from the offset, if they become eligible, prior to December 1, 1982, for a public pension based on noncovered employment.)

This provision is designed to prevent the payment of a worker's pension from noncovered employment and a full social security spouse's (or widow's or widower's) benefit. This is similar to the provision in the law under which a social security worker's benefit and a full social security spouse's benefit cannot both be paid to the same individual under the social security program due to the "dual entitlement" provisions (explained below). In discussing the need for the offset provision, the Senate Committee on Finance stated in its report on H.R. 5322 (which contained the offset provision substantially as it was later enacted):

> Under the social security program, an individual who is entitled to two benefits does not receive the full amount of both benefits. For example, if one is entitled to both a worker's benefit and a spouse's benefit, the full worker's benefit is paid first and then the amount (if any) by which the spouse's benefits exceed the worker's benefit. This "dual entitlement" provision prevents payments of dependents benefits to some persons not truly dependent. However, persons who receive civil service pensions based on their work in noncovered employment and are entitled to social security spouses' benefits, receive their dependent spouses' benefits in full, regardless of their dependency on the worker. This results in "windfall" benefits to retired government employees . . . In general, this should assure that dependents' social security benefits will not be paid to persons not dependent on the worker.

POSSIBLE PROGRAM CHANGES

Currently, only people working in jobs covered by social security pay into the system. There is, however, more and more discussion about using the income tax (general revenues) to collect part of the social security funds needed in the future. Under this proposal, all people with taxable income would pay into social security. Unless the eligibility criteria were changed, however, a person not working in covered employment would accrue no benefit rights from these taxes.

Some supporters of general revenue financing argue that such a change would make the system more equitable, since part of the cost of the program results from people who work only long enough in

covered employment (possibly by moonlighting) to become eligible for benefits, and receive a disproportionately high return on their tax dollars.

Since termination of social security coverage is irrevocable, groups that had elected to leave the program would not have the option to rejoin in order to reap some benefit from the taxes they would be paying.

WITHDRAWAL IS IRREVOCABLE

Once social security coverage is terminated for a governmental entity, it may never again be provided for that entity.

The Case Against Social Security

The issue of terminating social security coverage is not one-sided. While the committee has serious concerns about the loss of that coverage, leaving the social security program is not detrimental for every individual in every circumstance. Indeed, some people may gain certain advantages by leaving the program.

When asked why they were considering leaving the social security program, the overwhelming majority of State and local groups in our survey stated that their primary concern centers on the cost of the program, rather than on the protection offered by social security. Even those who choose to leave social security coverage generally attest to the superior protection offered under the program. However, for some, all of the protection offered by the social security program may not be necessary or desirable.

The following is a list of reasons for leaving the social security system which the committee feels are valid and well thought-out concerns for certain individuals. State and local government employee insurance plans are so numerous and diverse that this discussion must be presented in general terms; the committee stresses that the advantages presented here that other plans may have over social security are not necessarily present in any particular plan, nor is it likely that any plan would have all of these advantages. While there may be additional reasons spurring any particular group to leave the program, the following represents the concerns with broadest applicability.

INDIVIDUAL MONEY'S WORTH

One of the most common themes the committee heard from groups considering dropping social security coverage was that some individuals felt that they could "do better" either by withdrawing from social security in order to join another plan, or by investing the same amount of money that would go to social security into private investments. Many voiced the opinion that both of these alternatives would allow them to obtain superior protection, or gain the same protection at a lower cost.

It is clear that, for some workers, the full spectrum of protection offered by social security may not be worth the cost, yet there is no provision under the program for a worker to select the kinds of protection he or she truly needs. For instance, under the social security system, a worker pays taxes for survivor's insurance, even if he or she has no dependents. This can be a distinct disadvantage of social se-

curity. On the other hand, at the State and local level, there are more and more plans being developed to offer the worker a choice about the kind of insurance he or she is buying. For instance, in the State of Alaska, the plan replacing social security is a "cafeteria plan" that allows each worker to select from among a number of different kinds of insurance. Thus, the worker can buy exactly the kind of insurance he or she feels is most important.

An additional problem with social security is that, even after a lifetime of contributing to the program, it is possible that the worker would receive no benefits. If a person dies and leaves no survivors, only a $255 lump-sum death benefit is payable. An additional drawback to social security is that there is no provision that allows a worker to withdraw the taxes paid into the system, even if the worker does not have enough quarters of coverage to be insured. On the other hand, some State and local plans allow an employee the option of withdrawing his or her contributions to the plan when leaving that position.

While the committee believes that most people get a favorable return on their social security tax dollars, the concern about the price tag of the program is a reasonable one considering what has happened to the cost of the program since its beginning. For the first 13 years the social security taxes were payable (1937 to 1949), the maximum yearly tax was only $30 each on the employee and the employer. Twenty years later, that amount had risen more than 1,000 percent so that in 1969 the maximum yearly tax was $374 each on the employee and the employer. Yet this amount is dwarfed in comparison with the maximum yearly tax of $1,588 each on the employee and the employer payable in 1980, and the end of these increases is not in sight. Even allowing for inflation, the increase in the cost of the program has been considerable.

While there are many factors that have contributed to the dramatic rise in the cost of the program—an unrealistically low tax rate at the beginning, liberalized benefits, inflation, etc.—an analysis of these factors is not within the scope of this paper. However, these figures underscore the reasons for the concern about what appears to be runaway cost increases. Unfortunately, programs that have a significantly lower cost also pay lower benefits. There is no way around this fundamental fact. Of course, there may be employees who have sufficient sources of income protection to allow them to opt for a plan with a lower cost and lower benefits without suffering hardship.

The committee urges anyone making the decision to leave social security in order to join a lower cost plan to shop wisely. Above all, be sure that the lower cost does not result from a "cap" on the cost-of-living increases, since this can wreak havoc on the buying power of benefits under the plan. (For an example of what this can do to benefits, see the charts presented earlier in this chapter.)

LACK OF CONTROL

There are at least some State and local groups who believe that the social security program is being directed by an isolated group within the confines of the Nation's Capital and they feel this group is out of touch with the needs of workers elsewhere in the Nation. Several groups

stated that their own State understands their needs better than the Federal Government, which they say tends to be unresponsive to their desires. Specifically, these groups complain that the social security program has been "watered down" by benefits they characterize as welfare payments. These groups also express frustration over what they perceive to be their inability to change anything about the social security system, and believe that a plan developed and administered at the State or local level may be more responsive to their needs.

Since social security is a program that must serve millions of people from several generations, it tries to be all things to all people. For this reason, almost no one will be completely satisfied with the program. While the committee believes that social security is a sound and valuable program, it is quite possible that a plan developed on a State or local level, serving a smaller and less diverse group of people, might be more responsive to the needs of that group.

RETIREMENT AGE AND THE SOCIAL SECURITY RETIREMENT TEST

One advantage that other plans almost always have over the social security system involves age of eligibility for retirement benefits. While State and local retirement plans vary widely, they generally allow retirement with full benefits earlier than does social security. In general, the groups surveyed were under plans that provide retirement benefits at age 55. A few plans allowed for retirement as early as age 50. Generally, the retirement benefits were based on a percentage of salary (usually 1.5 to 2 percent) multiplied by the number of years of service. Some of the plans had length-of-service requirements, but the committee found these requirements to be fairly liberal.

Under social security, of course, full retirement benefits are not payable until age 65, with reduced benefits payable as early as age 62. In general, this age requirement is less liberal than other plans.

An additional problem with social security is that retirement benefits are subject to a "retirement test." This means that social security benefits are reduced if the individual still has substantial earnings. In 1980, an individual 65 or older can earn up to $5,000 before his or her retirement benefits are affected. However, for every $2 earned over that amount, called the exempt amount, the social security benefit will be reduced by $1. Individuals below age 65 are allowed to earn only $3,720 in 1980 before this $1-for-$2 offset applies. At age 72 (age 70 beginning 1982) this offset no longer applies.

The exempt amount is scheduled to go up as wages go up. In 1981, for instance, the exempt amount is scheduled to go up to $5,500 for workers age 65 or over, and $4,080 for those below age 65. Moreover, unearned income, such as dividends and investment income, does not apply toward the exempt amount.

The retirement test is designed to determine if the risk insured against—loss of income because of retirement—has actually occurred. However, many Americans resent the retirement test since they view the retirement portion of the social security program as an annuity, rather than as insurance. They consider that, after a lifetime of contributing to the social security program, retirement benefits are an earned right, and should not be reduced on the basis of other income.

OFFSETS

There is little rational argument against terminating social security coverage in some circumstances. The committee found at least one such case among the groups surveyed. When asked for the major reasons for terminating social security coverage, one group responded:

> Our public employee retirement system was coordinated with social security and to that extent the allowance at retirement was reduced by the amount of the social security benefit. Yet the employee was required to contribute to both systems. By getting out of social security when we did, most of us will still receive a social security benefit at retirement plus an unreduced benefit from PERS and our contributions will have been much less.

In this group, where the idea to terminate originated with the employer, almost all of the employees expect to be eligible for social security benefits based on their covered employment before termination, but will now pay only 7 percent of their wages, instead of 13.13 percent (the combined cost of the PERS and social security). In this case, by terminating social security coverage, the PERS benefit is no longer offset for receipt of social security. (There are cases where the PERS benefit is offset by a portion of any social security benefit received even after the group terminates social security coverage.)

For the employees in this group who are already insured for social security benefits, there is no logical way of arguing against ending social security coverage. Of course, new employees will not be covered by social security, and will have no opportunity to get social security coverage in this job.

DEFINITION OF DISABILITY

Under social security, there is an extremely strict definition of disability. In addition to meeting the insured status requirements, including the recency of work test, an individual must be "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months." (In the case of blindness, the insured-status requirements are less stringent.) It can be very difficult to collect social security disability insurance benefits: If, considering age and educational background, a person is able to work at any job in the national economy, regardless of whether such work is available, or where it is located in the country, that person is ineligible for social security disability insurance benefits.

Under many other plans, the definition of disability is more lenient. Some plans have an occupational definition of disability so that inability to carry out the requirements of the position the worker is currently engaged in is all that is needed to qualify for disability benefits. Of course, there are pros and cons in any argument; many plans that have a more liberal definition of disability put a restriction on how long benefits are payable.

WINDFALL BENEFITS

The last argument in the case against social security coverage is one of the most compelling. Under present law it is possible to become eligible for social security benefits through a relatively short time in covered work. This allows many individuals to gain social security coverage through part-time work when their full-time position is not in covered employment.

Individuals who gain coverage in this manner are advantaged. They pay low social security taxes since they have little income subject to the social security tax. Furthermore, although their income may be quite high, they have low earnings for social security purposes, and thus they receive an unduly high return on their tax dollar under a benefit structure designed to help low-income workers. This results from the fact that the social security benefit formula does not distinguish workers with lifetime low earnings in covered employment from workers who work only part-time in covered employment. While this situation disadvantages the program as a whole, it can work to the advantage of workers who terminate their social security coverage.

Chapter 6

A COMPARISON

In its survey of 55 State and local government groups nationwide, the committee obtained information on the various retirement plans some groups adopted when social security coverage was terminated. The time and difficulty involved in preparing benefit and cost comparisons between social security and all of these various plans makes analysis of each different plan impractical. However, to gain some idea of how social security compares with a typical local retirement plan, this section offers an analysis of one local plan before and after termination of social security coverage. In this analysis, the committee relied heavily on technical assistance from the Social Security Administration, Office of the Actuary.

The plan selected for this comparison is a local plan covering a group of employees in California. This plan was chosen for two reasons. First the plan is not unlike State and local retirement plans nationwide—it neither understates nor overstates the protection generally provided by these plans. Second, this retirement plan pamphlet is somewhat more detailed in its description than those of the other groups, thus facilitating comparisons, although as noted below, some pertinent information is still unavailable.

Problems in Making Comparisons

There are some difficulties inherent in any attempt to compare two retirement plans, and particularly in comparing social security with any other retirement plan, since no private plan can duplicate certain of the benefits and characteristics of social security. Some of these features are: (1) Unlimited benefit increases directly linked to the Consumer Price Index, (2) nearly universal portability of contribution credits, (3) tax-free benefits, and (4) automatic changes in type and level of benefits as the employee's family status changes, without variation in contribution rates. On the other hand, the social security program has never been intended to provide a complete retirement system but, rather, is meant to be supplemented by private pension plans and private savings. Thus, any attempt at a dollar-for-dollar comparison between the two would be quite difficult and even misleading because of the dissimilarity in benefit protection.

An additional problem in making comparisons is that it is impossible to arrive at a single, precise answer demonstrating that one plan is superior to another. For one thing, cost and benefit protection can vary widely according to the age, service, and earnings characteristics of the participants in the plan. For example, in a group that is currently covered by social security, but is considering dropping social security in lieu of another plan, participants who have attained fully

insured status under social security prior to termination (or from other employment) would obviously reap the advantages of both social security and the benefits of the new plan. Conversely, participants who failed to attain fully insured status would receive benefits only from the new plan.

As indicated in their response to the committee's questionnaire, between 40 and 60 percent of the current participants in the plan analyzed here will receive social security benefits upon retirement. It is quite possible that withdrawal from social security will be advantageous for these employees since the value of social security benefits relative to social security taxes tends to be greatest for low-income or short-service workers. However, as these people retire and are replaced with new entrants who will not have had the benefit of past social security coverage, the complexion of the situation changes, and withdrawal may prove to be disadvantageous for the new employees.

Background

The 21 employees of the local group were withdrawn from social security coverage effective December 31, 1977. The major reasons stated for termination of coverage were to provide equal or better benefits at less cost, and to increase take-home pay. Actually, employees were burdened with a plan that had benefits as well as costs that were unduly high, considering social security protection was also available. Employees voted 19 to 1 in favor of withdrawing, and expressed their approval of the action taken.

The decision to withdraw followed discussions with representatives of the Social Security Administration. Further discussions with the County Public Employees Association convinced the group that withdrawing from social security would achieve the goals of equal or better benefits with more take-home pay.

On average, employees of the group have short service (less than 5 years), are between 41 and 50 years of age, and earn between $10,000 and $15,000. About half the present employees are expected to become eligible for social security benefits when they retire despite the termination of social security coverage. In fact, a number of the seasonal employees are already drawing social security benefits.

Provisions of the New Plan

The employees are now covered under a retirement plan for county employees, referred to here as the "new plan." (Prior to the termination of social security coverage, the group was covered by a plan—referred to throughout as the "old plan"—that supplemented social security. When social security coverage was dropped, the supplemental benefits under the old plan were expanded. It is important to note that, unless otherwise stated, the old plan does not include the additional cost or benefits of the social security coverage itself).

Many of the provisions of the new plan are quite generous in comparison to social security and pension plans in private industry. In certain other areas, provisions are either less generous or not specified sufficiently to permit comparisons.

COST

As might be expected, the new plan requires substantial contributions by both the employees and their employer to pay for the relatively generous retirement provisions (a discussion follows). The employee contribution rates under the new plan are 20 percent higher than under the old plan. The employee's cost (expressed as a percent of pay) varies depending on the age at which he or she entered the plan:

[In percent]

	Old plan	New plan	Difference
Age at entry:			
16	7.49	8.99	1.50
25	8.13	9.76	1.63
35	8.89	10.67	1.78
45	9.69	11.63	1.94
54 and over	10.46	12.55	2.09

As a result of the withdrawal from social security coverage, employees are now paying the higher contribution rates. Thus the termination of social security coverage is costing employees of the District between 1.50 percent and 2.09 percent of pay in additional retirement plan contributions (but employees still realize a savings, since the cost of social security has been eliminated).

The employer cost is 10.17 percent of payroll plus $28.34 annually per employee, so that the employer is paying about half the cost of the plan.

RETIREMENT BENEFITS

Among the aspects of the new plan which are very liberal and contribute to the high cost are the early retirement provisions and the basic benefit formula. A participant may retire as early as age 50 with 10 years of service with a basic benefit calculated from his average salary using the highest 12 consecutive months of earnings. However, the retirement benefit is subject to a reduction of approximately 6 percent for each year by which retirement occurs before age 55. Retirement after age 55 increases the regular benefit by 4 to 7 percent for each year retirement is later than 55, although the benefit cannot be higher than preretirement earnings. Members are vested for benefits after 5 years of service.

In addition to liberal age and service requirements, the new plan also has high "replacement rates" (the ratio of benefits to preretirement earnings). A participant who retires at age 55 with 30 years of service, for example, receives a $60 benefit for every $100 of average salary giving a replacement ratio (before taxes) of 60 percent and a significantly higher after-tax replacement ratio. With longer service and/or higher retirement ages, retirees can receive *after-tax* replacement rates of more than 100 percent.

In contrast, while replacement ratios under OASDI vary substantially by retirement age, career earnings level, family status, and other factors, under comparable circumstances replacement ratios are significantly lower, reflecting the "floor of protection" nature of social security benefits. In addition, social security retirement benefits are not payable until age 62.

In this case, retirement benefits for workers under the new plan are 20 percent higher than benefits for employees under the old plan (excluding social security benefits). For example, at age 55 with 15 years of service, retirement benefits for employees under the old plan are 25 percent of highest year's pay (1⅔ percent per year), but are 30 percent for employees under the new plan (2 percent per year). Of course, the cost of the new plan is also 20 percent higher.

It is important to note that, although retirement benefits (and costs) are 20 percent higher under the new plan, this 20-percent increase does not fully compensate for the loss of the social security benefits that would also have been payable to employees under the old plan.

The retirement benefit percentages per year of service at selected retirement ages are as follows:

RETIREMENT BENEFIT

[As percent of highest year's salary]

	Old plan	New plan	Difference
Retirement age:			
50	1.242	1.490	0.248
55	1.667	2.000	.333
62	2.354	2.824	.470
65	2.611	3.133	.522

It should also be kept in mind that the advantage of the new plan benefits is partially offset by the Federal income tax on a large portion of the benefits that must be paid by the recipient. Since social security benefits are fully tax exempt, total benefits received under the old plan plus social security were less subject to tax than benefits under the new plan. The impact of this different tax treatment would depend on the recipient's other income, age, and so on.

OTHER RETIREMENT PLAN PROVISIONS

Benefits are fixed after payment begins instead of being adjusted for inflation in any way. Therefore, employees under the new plan are not only receiving considerably lower initial benefits than the combined benefits under the old plan plus social security, they are also receiving benefits that are not adjusted for increases in the cost of living. For employees under the old plan, the social security portion of the benefit would be fully adjusted for benefits.

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Portability of benefits is provided under a reciprocal agreement with a number of other California retirement systems. Under these reciprocal agreements, the member's credited service, contribution rate, and pay computation are not adversely affected by a change in employment.

Members' contributions are credited with interest semiannually. When employment terminates, accumulated contributions, except those for survivor benefits, may be withdrawn, subject to a withdrawal charge of 50 percent of the interest earned (up to $35). At rehire, after 5 years of service, prior service is restored if contributions previously refunded are repaid with interest.

Credited service includes all government service (Federal, State, local, military) including service outside the plan provided no other retirement benefit is received for such service.

Optional forms of retirement benefits may be elected instead of the regular benefit form that continues 60 percent of the pension to the surviving spouse or unmarried children under 18. These optional forms may provide either for payment to the member's joint annuitant of a percentage of the benefit that was payable during the member's lifetime, or for payment of any remaining employee contributions, with interest, that had not been paid in retirement benefits during the member's lifetime. Any of these optional elections requires a reduction in the regular retirement benefits.

DISABILITY BENEFITS

Under the new plan, an employee is considered to be disabled if found to be permanently unable to perform the duties of his or her job. This definition is more liberal than the definition of disability under social security. Five years of service are required before an employee is eligible for disability benefits on the basis of a nonoccupational disability. This is similar to the requirement for social security disability insurance benefits in many cases, however, under social security a young worker needs only 18 months (or less in some cases) of social security covered employment to be eligible for social security disability insurance benefits.

The plan is more liberal than social security in that it has no minimum age or service requirement for an occupational disability benefit (in contrast to social security which does not differentiate between occupational and nonoccupational disabilities for eligibility purposes). Moreover, for a service-connected disability, the minimum benefit under the plan is one-half of final pay. Nonservice disability benefits are paid at the basic retirement level. In addition, regardless of whether or not the disability is service connected, a $300-per-month supplemental benefit is also paid if the employee is unable to work in *any* gainful employment. It is the responsibility of the employee to provide proof of disability.

Another advantage under the new plan is that disability benefits are apparently not offset by worker's compensation benefits, as they may be under social security.

OTHER PROVISIONS OF THE PLAN

Several other types of benefits may be payable under the new plan, as summarized in the table that follows:

Circumstance	*Benefit*
A. Death after retirement—	
1. At death after service retirement or nonservice-connected disability retirement.	60 percent of pension, payable monthly to spouse or unmarried children under 18.
2. At death after service-connected disability retirement.	100 percent of pension, payable monthly to spouse or unmarried children under 18.
3. At death after retirement a burial allowance is also paid.	$750 lump sum.
B. Death from service-connected causes--	50 percent of salary, payable monthly to spouse or unmarried children under 18.
C. Additional benefits at death before retirement after 18 months of membership—	
1. Lump sum payments:	
a. At death before retirement, unless member was eligible to retire had he or she lived and spouse or guardian elected monthly survivor allowance.	Lump sum payment of accumulated normal contributions plus 1 month's salary per year of service (maximum 6 years) for which retirement contributions were made.
b. Additional lump sum payment at death of worker.	$255 lump sum.
2. Monthly survivor payments to spouse and/or children (if child is unmarried and under age 18, a full-time student under age 22, or became totally disabled before 18):	Monthly payments of:
a. Spouse with 1 child----------	$591.80
b. Spouse with 2 or more children ----------	690.40
c. One child only----------	295.90
d. Two children only----------	581.80
e. Three or more children-------	690.40
f. Widow or widower at 62------	327.10
g. Two dependent parents at 62--	591.80
h. One dependent parent at 62---	325.50

HEALTH BENEFITS

One important area in which the comparison is not clear (based on our available information) concerns hospital and medical insurance after retirement. Under social security, part A (hospital insurance or HI) medicare is available to persons age 65 and over (or under age 65 if they have been receiving social security benefits on the basis of a disability for 2 years) and are eligible for a social security monthly benefit. The terminating employees of the group, if permanently insured under social security, would be eligible for HI benefits. New employees often would not become eligible, however, and what information we have on the new plan suggests that the retirees must pay a substantial portion of their group medical insurance costs. Without HI coverage, these costs would be substantial.

COMMENTS

RETIREMENT BENEFITS

Benefit levels payable at retirement appear fairly generous—2 percent of pay per year of service at age 55, for example, so that a 30-year employee would receive 60 percent of pay. However, under the plan, the benefit levels existing before termination of social security coverage, *but not including the value of the social security protection*, were not much lower—1.667 percent of pay per year of service at age 55, for example, so that a 30-year employee would receive 50 percent of pay. (As already noted, this 20-percent increase in benefits is matched by a 20-percent increase in cost.) While it can be reasonably argued that benefits under the old plan, plus social security, were too high, benefits under the new plan may be too low. Moreover, benefits under the new plan are not adjusted for increases in the cost of living, so that, even if the initial benefit level is adequate, the buying power of the benefits may be seriously eroded by inflation. Since employees under the old plan were also covered by social security, this was a less serious problem for them, because the social security portion of their retirement income kept up with inflation.

No additional spouse's benefits are payable under the new plan. Clearly this means a loss of benefits for one-earner couples.

In theory, the new plan appears to allow employees in their 50's to retire. In practice, employees who elect to retire early under the new plan may find that their benefits are soon eroded by inflation. Without other substantial sources of income they may not be well advised to retire before they are forced to. This is especially true for one-earner couples.

The net effect of the change was to substantially reduce the employee's retirement income.

DISABILITY RETIREMENT BENEFITS

Members who qualify, receive benefits that, at the outset, are quite generous. In addition to the benefit percentages cited earlier for service retirement, the new plan pays $300 per month to help compensate for the loss of social security benefits.

The stated tests of disability are relatively liberal and it is not clear how heavily the new plan will rely on the proof of disability furnished by employees. This aspect of the new plan may make the disability benefits very easy to obtain since the existence of a disability is often highly subjective.

No additional disability benefits are paid to family members during an employee's lifetime. In comparison to social security this often would be a major disadvantage.

Because the disability benefits are not adjusted for inflation they may quickly lose substantial amounts of purchasing power.

DEATH BENEFITS

At death after retirement, except for service-connected disability retirement, the survivor benefit percentages under the new plan are below those of social security. For example, a surviving spouse the same

age as the employee spouse receives 60 percent of the retirement benefit (which is already significantly lower than the benefits employees would have received under the old plan plus social security), rather than the social security benefit of two-thirds of the combined worker-spouse benefit.

Here again, none of the survivor benefits are adjusted for inflation—a major disadvantage.

At death from service-connected causes, the extra benefit of one-half of annual salary is quite generous.

The schedule of monthly survivor payments is not related to pay, so it does not attempt to replace the level of income lost by death of the worker.

OTHER PROVISIONS

As noted earlier, the lack of adjustment for inflation after benefits begin is a major disadvantage.

Portability of benefits is limited to employment with local California jurisdictions that have reciprocal agreements with the local group, and to other government employment for which no retirement benefit is payable.

Rules for return of employee contributions and for restoration of broken service are fairly liberal. However, since it takes 5 years to become vested under the new plan, members who leave during their first 5 years of service and do not return simply lose credit for this service.

On the positive side, initial retirement benefits are fairly generous and retirement age is more liberal. Moreover, the definition of disability under the plan is more liberal than under social security.

Conclusion

It can be easily argued that employees in this group were burdened by a plan that, combined with social security, provided excessive benefits at an excessive cost. However, the real question here is whether or not terminating social security coverage was the best solution to these problems.

In making comparisons, it is impossible to arrive at a single, precise answer demonstrating that one plan is superior to another. For example, cost and benefit protection may vary widely according to the age and salary of the employee. Several of the provisions under the new plan are more favorable than under social security (for example, a more liberal retirement age and definition of disability). Overall, however, it is not clear that the goal of reducing costs and benefits to reasonable levels was best served by terminating social security coverage, since, by so doing, several important advantages of social security—most especially, cost-of-living benefit adjustments—were sacrificed.

While the committee is sensitive to the motives that led to the termination of social security coverage for this group, we believe the employees would have been better served if social security coverage were retained, and the cost benefits under the old plan (which supplemented social security protection) were trimmed. This could have eased the financial burden on the employees (and the employer), provided adequate benefits, and preserved the advantages that only social security can offer.

Chapter 7

GUIDELINES FOR ANALYZING A STATE OR LOCAL INCOME REPLACEMENT PLAN

Deciding about an income replacement plan is a difficult task. Workers should exercise the same care in choosing an income replacement plan that they would exercise with any other major purchase. These guidelines are intended to be used by employees who want to understand their pension plans better and who want a basis for comparison with other plans.

Although these guidelines cannot cover every kind of plan, nor take into account every item, they form a shopping list of considerations that employees should take account of when deciding about the kind of pension plan they want.

The guidelines were prepared with the assistance of the Social Security Administration and draw heavily from "Public Employee Pension Funds" by Robert Tilove, and the "Pension Task Force Report on Public Employee Retirement Systems," published by the Committee on Education and Labor of the House of Representatives.

Membership

The first criteria that should be examined when considering an income replacement plan is whether or not all employees would be eligible for membership in the plan. The committee saw several examples in its survey of State and local groups that illustrated the fact that not all employees in a particular group would be eligible for membership in a plan that is being considered in lieu of social security. Membership in some plans is limited to employees of a certain age or occupation (such as teacher) or may exclude part-time employees.

Retirement Benefits

Most employees feel that the retirement benefits offered by an income replacement plan are the benefits they are most likely to receive, and are thus the most important.

The following are examples of how benefits are calculated under different retirement plans. It should be noted, however, that a plan may use a combination of these formulas. Also, some plans guarantee that an employee's benefits will be no lower than a minimum amount.

FINAL-PAY PLAN

Under this plan, benefits are based on fixed percentage of final average salary times years of service. (Because these plans reflect salary increases up to the point of retirement they are generally more liberal than other plans.) The percentages used vary from plan to plan but

are usually between 1 and 2 percent. However, under some plans the percentage is variable—that is, the percentage increases at certain age or service intervals.

Earnings in one or several years are used in determining final average salary. Generally, benefits will be higher if fewer years are used in the formula and if the years used are later (because salary can be expected to increase as a worker's career progresses and as a result of inflation).

It is important to understand exactly what counts as a year of service. Under some plans, service for the employer prior to establishment of the current plan will count. In addition, some plans count similar service for another employer under the same plan (e.g., under a statewide plan). Still others count military service. Of course, the amount of credit allowed for these kinds of services may be limited to a maximum of, for example, 5 years. Also, if the services are to be credited, the employee may be required to pay additional contributions.

CAREER AVERAGE SALARY PLAN

Under this plan, benefits are based on a percentage of each year's salary. All else being equal, a plan based on final average pay produces a much higher payment than does a career-average formula (see table 1).

TABLE 1.—PERCENT BY WHICH BENEFIT BASED ON FINAL AVERAGE PAY OF 3 OR 5 YR EXCEEDS BENEFITS BASED ON CAREER AVERAGE SALARY UNDER IDENTICAL CIRCUMSTANCES

Percent of annual increase in salary	Percent of career average benefit							
	4 percent		5 percent		6 percent		7 percent	
Benefit formula based on	5 yr	3 yr	5 yr	3 yr	5 yr	3 yr	5 yr	3 yr
Years of service:								
25	142	148	154	161	165	174	176	188
30	154	160	169	177	184	194	198	211
35	167	173	185	194	203	215	222	236

MONEY PURCHASE ANNUITY

Here, the benefit is financed out of accumulated employee contributions and is based strictly on the amount of the contributions (i.e., using actuarial computations, the benefit paid is the amount that the contributions will buy). Benefits under this kind of plan do not reflect increases in salary levels throughout the worker's career, nor do they keep pace with inflation.

FIXED BENEFIT AMOUNT

Under this plan, the worker is paid a flat dollar amount per year of service. This plan is also usually less favorable for the worker than a final pay plan.

Early Retirement

Some plans have special provisions that permit employees to retire earlier than normal under certain circumstances. Of course, plans that offer early retirement usually reduce the benefits payable.

There are three kinds of benefit reduction methods most often used in determining early retirement benefits:

—*Actuarial reduction:* Benefits are reduced so that the total benefits paid will be equivalent to the total the worker would have received if he or she had started receiving benefits at the normal retirement age. (This is the least advantageous method for employees.)

—*Uniform reduction:* Benefits are reduced by a given percent (generally 6 to 7 percent) for each year the employee is below the normal retirement age. (This method is generally more advantageous to employees than actuarial reduction but may be less advantageous than the method described below.)

—*Reduction in percent:* The percentage used in determining the benefit is lowered. (This is often the most advantageous reduction method for employees.)

AN EXAMPLE

In this example, an employee under the Massachusetts public employee's retirement system retires at age 64 instead of at the normal retirement age of 65. Under this plan, the normal retirement benefit formula is 2.5 percent of final average salary per year of service.

If the employee's benefit was actuarially reduced, it would be 7 percent lower than at age 65.

If the benefit was reduced 6 percent for the 1-year lapse between actual retirement age and normal retirement age, it would be 6 percent lower than at age 65.

If 0.1 percent is deducted from the percent used in calculating the normal retirement benefit for the 1 year between actual retirement age and normal retirement age (as is actually done under the Massachusetts plan), the benefit would only be 4 percent lower than at age 65 (because a benefit based on a formula using 2.4 percent of final average salary is 4 percent lower than a benefit based on a formula using 2.5 percent).

Disability Benefits

Under most plans, a worker must have 5 to 10 years of service and meet the definition of disability under the plan in order to be eligible for disability benefits. However, there is a wide spectrum of definitions of disability under State and local plans. Some plans have a fairly liberal definition, based only on whether or not the worker is able to perform the duties of the current job, while others require that the employee be permanently and totally disabled in order to receive disability benefits under the plan.

There are several methods of calculating disability insurance benefits under different plans. It is important to understand how the plan determines benefits because the method used may radically affect the amount of the benefit. For example, some plans use the formula for normal retirement benefits but use the actual years of service. Therefore, a worker with a short length of service would get very low benefits. Other plans use the formula for normal retirement benefits but use the number of years of service the employee would have had if he or she had worked until normal retirement age.

Some plans pay a flat percent of salary. It is important to note that, no matter what method is used to determine benefit amount, some plans

put a cap—or maximum—on the amount of the benefit for disability benefits. However, if the disability is service connected, some plans provide for a more generous benefit.

One key point is that it is important to find out how long the disability insurance benefits are payable. In some cases, these benefits are paid only for a limited period of time, usually 5 years.

Death Benefits

EMPLOYEE IN ACTIVE SERVICE

Benefits to a worker's dependents in the worker's death (before retirement) is an aspect of retirement plans that is often overlooked when employees consider a new plan. However, these benefits may be very important to the financial security of a worker's family. Therefore, not only is it important to establish when and to whom these benefits are payable, it is also important to determine how the benefits are calculated. Here again, there are a wide variety of approaches that yield different benefit amounts.

The benefits that are paid may represent:

—A percentage of the employee's accrued pension benefits.

—A percentage of the employee's salary.

—A schedule of flat dollar amounts (this is common among plans that offer no social security coverage); or

—The survivor's portion of a joint-and-survivor annuity: The surviving spouse is paid the same amount as if the employee had retired on normal benefits appropriate to his or her years of service before death and had elected a joint-and-survivor benefit (see below).

EMPLOYEE RETIRED

Most plans give retiring employees options for providing survivor's benefits for their dependents. These options include:

—*A modified cash refund*—if the benefits paid to the employee by the time of death do not equal the amount of the employee's own contributions to the plan, the balance is paid to his or her survivors.

—*A joint-and-survivor annuity*—a percentage of the benefit received by employee will be paid to the surviving spouse. The employee's own pension, payable during his or her lifetime, is actuarially reduced to pay for the survivor pension; or

—*A return of reserve*—the lump-sum value of the entire pension is determined at retirement. If the benefits paid to the employee prior to death do not add up to this amount, the balance is paid to the surviving spouse.

Thus, it is important to understand the options in order to make the right choice, since survivor protection is often not automatically provided, and, at least in some cases, it is up to the worker to request the protection.

Benefit Replacement Rates

The percent of an employee's final year of earnings replaced by a plan (the replacement rate) generally ranges from a low of about 25 percent to a high of around 60 percent. The amount of earnings an employee must replace in order to maintain his or her standard of liv-

ing is lower than total salary, since contributions to the pension plan and any other work-related expenses, such as travel, uniforms, tools, group insurance premiums, are eliminated. In addition, lower income at retirement means lower Federal and State income taxes are payable.

Data from "Public Employee Pension Funds" by Robert Tilove, and the "Pension Task Force Report on Public Employee Retirement Systems" indicate that married employees who are covered under social security need a pension that replaces between 33 to 60 percent of their pay to maintain their preretirement standard of living. These employees generally had pensions that equalled or exceeded this amount if they had 25 years of service. However, married employees without social security coverage need a pension that replaces about 90 percent of their pay (at retirement) to maintain the same standard of living. However, even with 40 years of service, the overwhelming number of married employees without social security coverage do not have pensions that high.

Cost-of-Living Adjustments

Inflation causes the value of an employee's pension to decrease over time. The purchasing power of the pension of a person retiring at age 65 will have declined by 26 percent in 15 years if the cost of living increases at the rate of 2 percent per year; it will have declined by 40 percent if the cost of living increases at the rate of 3.5 percent, and, of course, in recent years the rate of inflation has been much higher than that.

Many plans do not provide for postretirement increases in benefits. Those plans that provide automatic increases generally use one of the following three methods:

—Fixed automatic adjustments (generally of 2 or 2.5 percent of the benefit per year).

—Adjustments based on other standards such as increases in the pay of active workers, or earnings of invested reserves.

—Adjustments based on increases in the consumer price index. (This is the most common type of automatic benefit increase, but the increase is usually subject to a limit of 1 to 3 percent).

Benefits under some plans are adjusted only on an "ad hoc" basis. While this is usually not as favorable as automatic adjustments, it can at least help to maintain the purchasing power of benefits. It is crucial to "shop" for a pension plan that offers at least some provision for cost-of-living increases, keeping in mind that a low benefit with cost-of-living increases may be more valuable than a high benefit that is not increased (see discussion in chapter 5).

Benefit Deductions

Just as benefits are sometimes adjusted upward to take account of increases in the cost of living, benefits under some plans are adjusted downward to take account of other benefits the employee is receiving, such as worker's compensation and social security. It is important to look for the fine print—find out if benefits under the plan are reduced to take account of other income, since this may seriously decrease the value of the plan.

Vesting and Portability

PROBLEMS OF CHANGING JOBS

When considering a new pension plan, one should determine whether credit for service under the plan can be carried to another job. Of course, social security is the most portable protection available. However, here again, there is a variety of approaches at the State and local level, with some State and local plans offering good intrastate, and even limited interstate portability. Other plans are much more restrictive.

An employee who moves from a job covered under one pension plan to a job covered under another will be disadvantaged unless credit is given under one plan for service under the other. Even if the employee retains rights to a benefit under the first plan, the eventual benefit will be lower because inflation will reduce the value of the past earnings. If either plan has a benefit formula which gives additional credit for years of service in excess of a certain number, the employee's loss will be even greater. Moreover, even if the employee becomes entitled to a benefit under the second plan, the benefit will be lower than if he or she had worked in the second job the whole time.

VESTING REQUIREMENTS

Plans generally require 5 to 15 years of service in order for an employee to preserve rights to benefits, or become "vested." Some plans permit employees who leave their jobs with vested pension rights to withdraw their contributions. Employees may be permitted to repay the contributions (plus interest) at a later date in order to "buy back" their right to a pension. The option of withdrawal of contributions is attractive to employees and may reduce pension costs; however, it can reduce the protection of the employees who leave.

Plan Financing

A key aspect of the desirability of any pension plan is its solvency. This, in turn, is dependent upon the manner in which the plan is financed. Most plans are financed by a combination of contributions from the employees and the employers, as well as income from the plan's assets. The amount of contributions required from employees varies among plans. Some plans require no employee contribution. Naturally, such a plan is generally popular with workers, but it is important to find out what the plan offers, since plans with low contribution rates often pay inadequate benefits.

In some cases, employees pay contributions at different rates depending upon their occupation, age of entry into service, or sex. Additionally, under some plans, employees contribute at different rates depending upon salary level. The amount contributed to income replacement plans by employers varies widely. At the State and local level, the employer contributions generally exceed the employee contributions, but some plans have no employer contribution at all.

Pension plans generally invest the contributions in a variety of stocks, bonds, and other securities that will increase in value and/or

pay dividends on interest. The assets of a plan should be actively managed. A persistent lack of turnover of a plan's assets under changing circumstances may indicate a lack of active management and spell losses for the plan members. Further, a plan's investment should be diversified in order to minimize the risk of large losses. It is desirable for a plan to conduct periodic studies to compare its investment results with those of other funds, other institutional investors, and market indices.

Funding

"Funding" refers to any schedule or plan for financing a retirement system. There are many kinds of funding and it is beyond the scope of these guidelines to discuss their comparative merits and shortcomings. However, there are two basic kinds of funding:

—*Pay-as-you-go funding* in which the plan has only enough money to meet the system's current expenditures; and

—*Reserve funding* in which the plan has a financing arrangement under which the current contributions are in excess of current benefit payments and the excess contributions accumulate in a fund. Reserve funding may be on an actuarial or nonactuarial basis.

It is desirable for income replacement plans (particularly small plans) to be funded on a reserve basis. Some advantages of this kind of funding are that:

—It recognizes ultimate pension costs and systematically provides for current payment of some of those costs; it does not irresponsibly leave the costs of improvements to the plan to future employees.

—It reduces the ultimate level and aggregate amount of contributions needed to finance the system because of the investment income earned on the assets of the plan. (Typically, for actuarially funded plans, the investment earnings will meet 25 to 50 percent of total pension costs.)

—Most importantly, it secures the pension right of members by insuring that the necessary money will be available to meet pension claims as they become due.

Changing from pay-as-you-go to reserve funding may initially result in an adjustment of contributions to insure adequate financing of future benefits, but will probably save money in the long run.

Accounting and Auditing

To insure adequate funding, an actuarial valuation of the plan should be performed at least once every 3 years. This valuation should be performed by a qualified actuary. Further, it should be done on a "dynamic" basis—that is, it should reflect, for example, increases in salaries and benefits due to inflation. In addition to an actuarial valuation every 3 years, the plan should be audited annually by a licensed or certified accountant outside of government.

Management of Plan Assets

In addition to adequate funding, a plan needs good management if it is to remain solvent and keep costs down. Even the best designed plan can fail to meet the needs of participants if it is poorly admin-

istered or subject to pressure from proponents of other interests. The duties of plan administrators include managing the assets of the plan. One problem has been that the persons who are responsible for the plan (trustees) often do not have the special expertise needed to invest the assets most profitably. Conversely, those who have the expertise may not be authorized to act quickly on behalf of the plan in making advantageous investments.

While these opposing problems are difficult to overcome, two good approaches are having an "approved list" of securities that the investment manager is authorized to buy or sell without approval each time from the plan trustees, or concentrating investment management of several pension systems in a single State agency.

Obviously, an income replacement plan should be designed to benefit plan participants. Sometimes, however, the plan is designed in part to aid local interests. Some plans restrict investment to the local area, while others are required to be managed by local investment advisors, such as local brokerage firms.

It is difficult to advise employees on how to avoid these pitfalls. However, the more informed and involved the employee population is, the less likely it is that these abuses will occur. Therefore, it behooves employees to become informed in order to protect their interests.

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Chapter 8

PROBLEMS ARISING FROM PRESENT LAW

This chapter outlines some of the problems that can arise from the present approach to covering State and local government workers. These problems can arise when social security coverage for a State or local government group is terminated, or when this coverage is never instituted, and may be divided into two groups: (1) Those that affect only the employees involved in the termination, and (2) those that affect the program as a whole. It is worth noting that some of the problems that affect only the employees involved are not limited to State or local workers. Rather, they may apply to any worker who works part of his or her career in a noncovered position.

Problems That Affect Only the Employees Involved

UNWILLING TERMINATION OF COVERAGE

One of the most serious problems with present law is that it does not prevent situations in which social security coverage is terminated in spite of the fact some employees wish to retain their social security coverage. This situation occurs frequently in coverage groups that are made up of employees in a variety of occupations (e.g., teachers, police, and firefighters) with very different employment-related benefits. Often, the entire coverage group has social security coverage terminated because one faction of employees believes it has adequate insurance protection without social security coverage. For other employees in the group, however, who are not eligible for the same employment-related insurance protection, loss of social security coverage may mean being left with no insurance protection.[1]

The same problem can occur when social security coverage is ended through a unilateral decision by the employer. In this case, a substantial majority, or perhaps all, of the employees involved may wish to retain social security coverage, but are not given a voice in the decision to terminate coverage. Few State or local entities require a vote of affected employees before coverage is terminated, and there is no provision in Federal law protecting employees from an adverse decision by their employer. In today's economy this is becoming a significant problem, since many State and local entities are terminating social security coverage as a money-saving device.[2]

A related consideration is that once coverage is terminated for a particular coverage group, that group can never again become covered. Therefore, all future employees in that coverage group lose the opportunity to be covered by social security, even if they desire that coverage and even though they had never participated in the decision to terminate coverage.

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[1] The committee found at least one example of this in its survey of State and local groups (see chapter 3 for a complete discussion).
[2] See footnote 1.

ALTERNATIVE PROTECTION MAY BE INADEQUATE

Many State and local employees who seek to terminate their social security coverage do so on the assumption that they can obtain comparable or improved protection at a lower price under an alternate plan. However, this is rarely the case. Many plans offer more generous retirement benefits, but lack adequate disability insurance, survivors protection, or health insurance. Moreover, even plans that offer higher initial retirement benefits are rarely fully adjusted to compensate for increases in the cost of living.[3] The net result can be that the buying power of retirement benefits under an alternate plan which were originally more generous than social security can be eroded so quickly that social security benefits, which are fully adjusted for changes in the Consumer Price Index, are soon superior (see chapter 5). This is particularly true when the nontaxability of social security benefits is taken into account.

Another consideration is that public employee retirement systems are not required to meet Federal standards that have been developed for private (nongovernmental) employee retirement plans. Therefore, some public employee retirement systems are inadequately financed. Often, the plan is financed completely on a pay-as-you-go basis, with very limited cash reserves.[4] While this may be suitable for the social security program, since it is backed by 90 percent of the national work force and administered by the Federal Government, it may not be adequate for a retirement plan involving a relatively small group of employees. Moreover, a State or local employer, facing a shortage of operating funds, may divert funds from the retirement system and use them for other purposes. In these cases there is a real question regarding the payment of expected benefits.[5]

GAPS IN PROTECTION

Gaps in insurance protection for workers and their dependents can result either because the State or local employment was never covered by social security, or because that coverage is terminated. Often, employees have not worked long enough to be permanently insured for social security benefits when coverage is terminated. Even those workers who are insured for retirement benefits under social security will lose eligibility for disability insurance in 5 years unless they have other employment covered by social security.

Similarly, individuals who switch employment between covered and noncovered jobs may have gaps in their protection. For instance, some individuals who have worked in both covered and noncovered positions will be eligible for benefits only under one system and, therefore, the benefits they receive will not reflect all their work. Others may not be eligible for benefits under either system. A case in point is that of a worker who leaves State or local noncovered employment and begins work in a job covered by social security. Since most public

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[3] "Pension Task Force Report on Public Employee Retirement Systems"; Committee on Education and Labor, House of Representatives, 95th Congress, 2d Session, Mar. 15, 1978. Page 108 of the report states that less than 5 percent of State and local government employees are covered by a plan that adjusts benefits automatically and without limit for increases in the cost of living as social security does.

[4] See footnote 1.

[5] Ibid.

employee retirement plans offer no carryover protection, if the worker becomes disabled or dies before working long enough under social security to be eligible for social security benefits, the worker and the worker's dependents would be left with no protection under either program.

Problems That Affect the Program As a Whole

WINDFALL SOCIAL SECURITY BENEFITS

The term "windfall benefits" is commonly used to refer to benefits that are based on less than a full career of earnings, and represent a very high return on social security taxes paid. Windfalls, like gaps in protection, can arise when an individual works part of his or her career in social security covered employment and part in noncovered employment. In this case, however, rather than being left without protection, workers realize an unduly high return on social security taxes paid.

As an example, windfalls can occur when a State or local worker, after several years employment, loses social security coverage (because the group he or she is in terminates coverage), or when an individual moves between private sector jobs, covered under social security, and public employment not covered by social security. These workers may become eligible for social security benefits, even though only part of their working career has been covered by social security.

Since social security benefits are based on average monthly wages in employment covered by social security, work not covered by social security is not included when determining the employee's average earnings. Therefore, individuals who work part of their careers in noncovered employment have an artificially low average of monthly earnings for social security purposes. However, social security benefits are "weighted" so that people with lower average earnings receive a benefit that replaces a higher percentage of their average earnings than do people with relatively high income. (This reflects the philosophy that individuals with low income can afford less of a cut in their income than individuals with higher earnings.) The net result is that workers who have only a part of their lifetime earnings reflected in the computation of their average earnings may gain an unfair, though legal, advantage by getting a very high return on their tax dollars under a provision in the benefit structure that was intended for low-income workers. Table 1 shows how the amount of taxes paid into the social security system drops off more quickly than the amount of the benefits derived from the system for those who spend only part of their career in covered employment. Further, workers who are eligible under another system, for benefits based on their noncovered work, can receive combined benefits that are higher than individuals who have had all of their work covered under one system. All workers covered by social security must bear the cost of these "windfalls." [6]

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[6] See footnote 1.

TABLE 1.—PERCENTAGE OF TOTAL EMPLOYEE SOCIAL SECURITY TAXES PAID AND PERCENTAGE OF PRIMARY BENEFITS ACCRUED UNDER ALTERNATIVE CAREER PATTERNS IN COVERED EMPLOYMENT[1,2]

Years of covered employment	Final salary					
	$15,000		$30,000		$50,000	
	Percentage of taxes paid	Percentage of benefits accrued	Percentage of taxes paid	Percentage of benefits accrued	Percentage of taxes paid	Percentage of benefits accrued
40 total: 1 to 40	100	100	100	100	100	100
35 total:						
6 to 40	88	100	89	100	90	100
1 to 5, 11 to 40	87	99	87	99	87	99
1 to 10, 16 to 40	86	99	86	98	86	98
1 to 15, 21 to 40	87	99	86	98	86	98
1 to 20, 26 to 40	87	99	87	98	87	98
1 to 25, 31 to 40	88	99	88	98	87	98
1 to 30, 36 to 40	89	99	88	98	88	98
1 to 35	89	99	89	98	89	98
30 total:						
11 to 40	75	90	76	94	77	93
1 to 10, 21 to 40	73	88	72	92	72	90
1 to 20, 31 to 40	75	88	75	92	74	90
1 to 30	78	88	77	92	77	90
20 total:						
21 to 40	47	69	48	76	49	77
11 to 30	52	68	53	76	54	77
1 to 20	53	68	52	72	51	73
10 total:						
31 to 40	22	49	23	48	23	51
21 to 30	25	47	25	48	26	51
11 to 20	27	47	28	48	28	23
1 to 10	25	47	24	43	23	43

[1] Primary benefits refer only to cash benefits paid to a worker, and do not include the value of any spouse, survivors, medicare, or other ancillary benefits.

[2] Derived from table 3–8 of "The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State, and Local Governments and Private, Nonprofit Organizations"; report of the Universal Social Security Coverage Study Group, March 1980, p. 36. The table presents data for hypothetical workers beginning work in 1981 and retiring in 2020. The computations assume 1-percent increases in productivity for each year between 1981 and 2020. The tax rates, used are those currently in the law.

ADVERSE PUBLICITY

Another problem with the present law structure of State and local coverage is that termination of that coverage creates adverse publicity for the social security program. The publicity that surrounds the withdrawal of a large group tends to undermine public confidence in the social security program and arouse the resentment of the general public, which, on the whole, is mandatorily covered by social security. Moreover, some groups base their decision to terminate on the philosophy that termination must be a good idea since so many other groups have chosen to do so.[7] In reality, however, the groups withdrawing from the program may have made an unwise decision.

PROGRAM PHILOSOPHY

Social security is considered the Nation's basic form of insurance protection. As such, the program must attempt to balance individual equity with social adequacy. It is a program that is pulled in both directions in order to achieve a comfortable compromise, and suffers criticism on both grounds. Some State and local workers choose to

[7] See footnote 1.

opt out of the social security system because they believe they are supporting a welfare program, from which they will see little return.[8]

Needless to say, the return on money paid in to the program varies with the individual. However, even those who believe they will not get their individual "money's worth" out of the program may be proven wrong since our expectations about life circumstances are not always borne out. Moreover, there is a reasonable argument that, just as a homeowner benefits from having fire insurance even if his or her house never burns down, a worker benefits from aspects of the social security program, such as disability insurance, even if he or she never actually becomes disabled.

In the final analysis, however, what is perhaps the most compelling problem with present law has little to do with individual "money's worth." Since social security is a social insurance program designed to provide a floor of protection in the event of retirement, disability, or death of the worker, the Nation as a whole should share in the cost of that program. In this light, it is difficult to rationalize allowing certain workers to exempt themselves from the burden of this responsibility.

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[8] Ibid.

Chapter 9

RECOMMENDATIONS BY VARIOUS GROUPS TO CHANGE PRESENT LAW

The debate about how extensive social security coverage should be, and who should be covered mandatorily, began with the birth of the social security program in 1935 and has continued ever since. Proponents of "universal" social security coverage, that is, mandatory coverage for the entire U.S. work force, cite problems that can arise when workers are not covered by social security, or move between social security-covered and noncovered jobs. Specifically, these workers may suffer gaps in their insurance protection, or may become eligible for minimum social security coverage even though most of their career was spent in employment outside the social security system. In the latter case, workers profit from a benefit structure that was designed to help low-wage workers but can actually help workers with high wages if most of their earnings are in jobs not covered by the social security program.[1]

On the other hand, opponents of universal coverage argue that efforts to eliminate problems caused by a lack of social security coverage for some workers may, in fact, lead to new problems, including significant administrative and financial burdens on the retirement systems not presently covered by social security.

Several advisory committees have been established to study various aspects of the program. In general, these groups have recommended extending social security coverage to all workers, or, at a minimum, reducing inequities in the present system by coordinating the social security program and noncovered retirement systems. The following is a summary of the most recent findings and recommendations regarding social security coverage for State and local government employees.

The 1979 Advisory Council on Social Security

> *The Council finds that our Nation's income security goals can be achieved fully and equitably only if all employment is covered by social security.*[2]

This sentence begins the Council's statement on social security coverage and sets the tone for the entire chapter. The Advisory Council consists of a panel of representatives of employers, employees, the self-employed, and the general public. Its function is to review the status of the social security cash benefit and medicare programs and report its findings and recommendations to the Secretary of Health and Human

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[1] For a more detailed discussion of windfall benefits, see chapter 8.
[2] "Social Security Financing and Benefits: Reports of the 1979 Advisory Council on Social Security"; Dec. 7, 1979, p. 161.

Services (HHS) and the Congress. The requirement for an Advisory Council on Social Security is set forth in the Social Security Act itself. That act requires that every fourth year the Secretary of HHS appoint an Advisory Council which, to the extent possible, represents employers and employees in equal numbers.

In addition to discussing problems resulting from excluding some workers from the program, the Advisory Council report also set out the strengths of the social security program that are "not evident in other wage replacement systems." These strengths include: (1) Portability of coverage; (2) updating of past earnings based on increases in average wages during the worker's lifetime; (3) adjustment in benefits for increases in the cost of living; and (4) providing benefits to the dependents of disabled and retired workers and to the aged dependents of deceased workers, even if the worker dies before reaching retirement.

In a definitive statement on the subject of universal social security coverage, the Council sets forth the following recommendation:

> *The Council recommends that social security coverage be extended to Federal employees either through mandatory coverage for new hires or through a transfer-of-credit plan. The Council also recommends that newly hired State and local employees and newly hired employees of nonprofit organizations be mandatorily covered by social security. The Council believes and intends that the combined protection of social security and supplemental plans for Federal, State, and local governments and of the nonprofit sector generally will at least equal present coverage. We oppose the merger of any existing staff pension fund with the social security trust fund.*[3]

In spite of its hard-line approach to mandating social security coverage for groups not already covered by social security, the Council seeks to insure that no worker would be unduly disadvantaged:

> Although the time has come to move forward to extend social security coverage, the Council recognizes the need to avoid reductions in benefits for those who have worked in noncovered employment for many years. It is important to achieve a balance between the desirable goal of extending coverage and the legitimate expectations of noncovered employees in arriving at specific plans for achieving universal coverage.[4]

Finally, recognizing that universal social security coverage may be some time off, the Council recommends as interim steps that:

> *A coordination plan be instituted for those who have earnings under social security and earnings from employment not covered by social security.*
>
> *Termination of agreements providing coverage for State and local workers not be permitted. (If this recommendation is not adopted, terminations should only be permitted after a vote of affected employees.)*

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[3] Ibid., p. 164.
[4] Ibid., p. 165.

The divided retirement system[5] *procedure be made available to all States.*[6]

The President's Commission on Pension Policy

The President's Commission on Pension Policy was established by Executive order in July 1978. The membership of the Commission, appointed by the President, is charged with responsibility to examine pension systems around the country in an effort to develop national policies for retirement, survivor, and disability programs that can serve as a guide for public and private programs. In carrying out that responsibility, the Commission is mandated to seek advice from interested individuals and groups, private and public organizations, Congress, and Federal Government agencies.

Although not scheduled to submit its final report to the President until February 1981, the Commission issued an interim report in May 1980. In this report, the Commission states that allowing 10 percent of the work force to remain outside of the social security program "results in certain inequities and inadequacies." These inequities and inadequacies are much the same as the problems the committee perceives with present law, including windfall benefits and gaps in protection, as outlined in chapter 8 of this paper.

While the Commission "expresses strong sentiment in favor of extending social security coverage to all noncovered employees,"[7] it recognizes potential problems in mandating coverage:

> At the State and local government levels, expanded social security coverage would result in an ultimate increase in pension costs for noncovered systems, even if the present pension formulas are redesigned to take account of social security benefits. This increase occurs because current public employee plan benefits and social security benefits are not duplicative in many areas. *The benefits offered by social security which are lacking in most public plans and which therefore are most responsible for the ultimate higher cost include: Improved health insurance; disability and survivor benefits; more adequate cost-of-living protection; and a fully portable benefit (which reduces the forfeitures that occur when nonvested employees resign).* (Italics added.)[8]

The Commission goes on to point out that extending social security coverage on a mandatory basis to all State and local workers could result in sizable increases in costs for newly covered State and local government jurisdictions during the transition period:

> The dual burden of paying the payroll tax and meeting obligations to current retirees would be especially acute for plans with substantial unfunded liabilities. Those State and local systems would need new ways to finance a higher level of pension obligations.[9]

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[5] For an explanation of the divided retirement system, see question No. 6 in chapter 1.
[6] References cited in footnote 2, pp. 166–167.
[7] "An Interim Report," President's Commission on Pension Policy, May 1980, p. 36.
[8] Ibid., p. 35.
[9] Ibid., pp. 35–36.

The Commission also addressed potential legal problems with expanding social security coverage on a mandatory basis:

> If social security coverage is extended, competing constitutional claims will be raised and would probably have to be settled in court. The outcome is difficult to predict because the implications of the most prominent Supreme Court precedents are uncertain. In some instances, the issues are further complicated by provisions of State constitutions and by conflicting court rulings.[10]

In light of the problems associated with extending social security coverage, the Commission repeats its statement in favor of extending social security coverage to all noncovered employees, but states that it will first determine "whether the windfall benefit and gap problem could be better solved by targeted amendments to the social security program," and will examine data showing the effects of alternatives to universal coverage that would remedy these problems.

Finally, the Commission states that, "if universal coverage is to be adopted, the Commission believes the feasible way would be to extend social security to new workers." [11]

The National Commission on Social Security

The National Commission on Social Security was established by Public Law 95–216, with some members of the Commission appointed by the President and some by Congress. The National Commission is currently engaged in a broad-scale, comprehensive study of the social security program.

Although the Commission has not yet issued its report, it has reached several tentative recommendations. They are as follows:

—To end the option of the States to leave social security (after a 1-year grace period for the filing of notices of intent to withdraw).

—To extend social security coverage to all State and local government employees not covered by a retirement plan.

—To extend social security coverage to all new employees of State and local governments.

—To reduce future "windfall" social security benefits (which result from the weighting of the benefit formula) for people who have significant amounts of noncovered employment. (The proposal would affect only future earnings.)

In a related proposal, the Commission considered and rejected the following:

—To mandate that State and local government employees be permitted to vote on whether to opt out of social security, while the termination option remains.

The Universal Social Security Coverage Study Group

In 1978, Congress directed the Secretary of Health and Human Services (then Health, Education, and Welfare), to establish the Universal Social Security Coverage Study Group, in order to examine

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[10] Ibid., p. 35.
[11] Ibid., p. 36.

the "feasibility and desirability" of legislating mandatory coverage for noncovered workers, including employees of State and local governments. To carry out this task, the Study Group was directed: (1) To review the extent of coverage of employees at all levels of government and in nonprofit organizations; (2) to develop options for and alternatives to mandatory coverage; (3) to analyze the organizational, fiscal, and legal effects of each option and alternative; and (4) to consult with other government agencies and with members of the public.

Although it does not issue recommendations, this report is particularly interesting because it is the first study on mandatorily extending social security coverage to noncovered workers that analyzes the issue in quantitative terms. The report, sent to the Congress in March 1980, is extremely lengthy and detailed, and only the major findings are reviewed here.

EXTENT AND EFFECT OF SOCIAL SECURITY COVERAGE

In analyzing the extent and effect of social security coverage, the report states that:

> Public employee retirement systems now cover approximately 10 million State and local government employees, protecting them and their survivors against income loss due to retirement, disability, or death. For approximately 72 percent of State and local employees, social security is an important addition to this protection. For the remaining 28 percent, however, the public employee retirement system constitutes the only income protection.[12]

The study group goes on to state that most participants in public employee retirement plans are covered by retirement benefit formulas based on a percentage of pay and years of service, and most receive limited disability and preretirement and postretirement survivor protection through their pension plans. Limited portability of this protection is available, but usually only to other governmental units within the same State. Benefits are adjusted to the cost of living after retirement, but the adjustments often are not automatic, or are set at a level—typically 2 to 3 percent—well below the inflation rate of recent years.

The document then concludes:

> *Although provisions of covered and noncovered systems are similar, participants in systems covered by social security generally have substantially superior protection.* Data from the Pension Task Force of the House of Representatives indicated that in 1976, annuitants in covered systems received a combined benefit 20 to 60 percent higher at retirement than did annuitants in noncovered systems. Furthermore, because social security is fully indexed, the purchasing power of benefits was also sustained. In all, covered employees pay more to the plan and to social security than noncovered employees pay. (Italics added.)[13]

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[12] "The Desirability and Feasibility of Social Security Coverage for Employees of Federal, State, and Local Governments and Nonprofit Organizations"; Report of the Universal Social Security Coverage Study Group, March 1980, p. XII of the executive summary.

[13] Ibid., pp. XII–XIII of executive summary.

LEGAL CONSIDERATIONS

While the Study Group addressed the fact that there may be legal barriers to mandating social security coverage for State and local governments, it does not attempt to predict what the outcome would be if the issue is brought to court:

> *Extending social security coverage to State and local government employees would raise competing constitutional claims.* * * * *How these competing constitutional claims would be resolved is unclear.* (Italics added.)[14]

TRANSITION CONSIDERATIONS AND THE COST

Recognizing that State and local governments may face challenges in implementing social security coverage for their employees if such coverage is mandated, the Study Group recommends a generous period of time in which to accomplish the changeover:

> The transition problems associated with mandatory coverage are more challenging at the State and local levels than at the Federal level. Elected officials, plan administrators, and employees need considerable time to determine the appropriate design for newly coordinated formulas and to devise approaches for meeting the higher costs. *The Study Group concluded that at least 4 years would be required for this process.* (Italics added.)[15]

The report analyzes two approaches to mandating universal coverage: (1) Coverage of new employees only; and (2) coverage of current workers plus all future employees. Of significant concern to the Study Group was the price tag that social security coverage could impose:

> Current public employee retirement protection and new social security coverage are not duplicative in several areas. The cost impact of mandatory coverage cannot be ascribed directly to specific provisions. Among the most important factors contributing to the cost increases are strengthening the cost-of-living protection; reducing forfeitures that occur when vested or nonvested employees resign (since part of retirement protection will become fully portable); designing special supplements for retirement before age 62 (especially in police and firefighter plans); and improving health insurance and disability and survivors' benefits.
>
> *Covering only new employees would mean that erasing all windfalls and gaps resulting from absence of mandatory coverage could take up to 40 years. Nevertheless, this approach may be preferred. The cost increases resulting from mandatory coverage would be phased in gradually.*
>
> *In contrast, covering current employees as well as new employees would impose sharp cost increases; the Study Group estimates that in the first year alone half the plans would*

[14] Ibid., p. XIII of executive summary.
[15] Ibid., p. XV of the executive summary.

face increases of between 2 and 7 percent of payroll. The goals of mandatory coverage would be achieved quite rapidly but at considerable cost to the employing jurisdictions. (Italics added.)[16]

IMPACT OF SOCIAL SECURITY COVERAGE ON CAPITAL FORMATION

In examining the potential impact expanding social security coverage could have on capital formation in the United States, the Study Group states:

Extension of social security coverage to State and local government employees would not be expected to disrupt capital formation in the United States. Extension of coverage would reduce the level of contributions now flowing into noncovered State and local plans, but the reductions would be small and would probably occur gradually. Compared with the potential effects of other long-term developments, particularly changes in plan funding and investments strategies, the effects of extending social security coverage to all State and local government employees seem relatively small and manageable.[17]

SUMMARY

It is apparent that the issue of extending social security coverage to workers not already under the social security system is an active one. Yet recommendations for universal coverage go back to the 1930's, and no such action has been taken to date. From recommendations already made, it appears that, even if universal coverage is enacted, it will probably apply only to new employees. Less predictable, however, is what future action, short of universal coverage, may be taken to correct some of the problems arising from the present situation.

Regardless of what specific actions may be taken, the committee recommends that any change in policy be equitable and be implemented in such a way that workers close to retirement, who have already formulated their retirement plans, will not have those plans disrupted.

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[16] Ibid., pp. XV–XVI of executive summary.
[17] Ibid., p. XVI of executive summary.

APPENDIXES

Appendix 1

SENATE SPECIAL COMMITTEE ON AGING QUESTIONNAIRE [1]

A. Termination Information

1. Please describe the major reasons for terminating social security coverage.

2. When did termination become effective?

3. Was the idea to terminate coverage first suggested by the employer or the employees?

4. a. Were employees given an opportunity to vote on whether or not to terminate coverage?

b. If yes, please give numerical outcome of the vote.

c. Why do you think the employees voted as they did?

d. If employees were not given an opportunity to vote, how much notice were they given that coverage was being terminated?

e. Generally, what kind of reaction did the employees have to the news of termination of social security coverage?

5. a. Did a representative of your group discuss termination with a representative of the Social Security Administration?

b. If yes, was the Social Security Administration representative helpful and informed?

c. Did a representative of your group discuss termination with the State Social Security Administrator?

d. What kind of information were you seeking from the Social Security Administration and/or the State administrator?

e. How did the information you received affect the group's decision?

6. a. Did a representative of the group discuss termination with other terminating groups?

b. If yes, what kind of information was your group seeking?

c. How did this information affect your group's decision?

7. What, if any, incentives to terminate were offered by the employer?

B. Employee Information

1. How many employees were in your coverage group when social security coverage was terminated?

2. What is the average age of the employees in your group? (check one):

[1] This questionnaire was sent to groups that had already terminated social security coverage. Minor changes were made for questionnaires to groups that rescinded notice of termination, or have notices currently pending.

a. 20 to 30.
b. 31 to 40.
c. 41 to 50.
d. 51 or older.

3. What is the average yearly salary of employees in your group? (check one):
a. $10,000 or less.
b. $10,001 to $15,000.
c. $15,001 to $20,000.
d. $20,001 to $25, 000.
e. $25,001 or higher.

4. What is the average length of service for employees in your group? (check one):
a. 1 to 5 years.
b. 6 to 10 years.
c. 11 to 15 years.
d. 16 years or longer.

5. What percentage of current employees expect to be eligible for social security benefits when they retire, even though coverage has been terminated? (check one):
a. 0 to 20 percent.
b. 21 to 40 percent.
c. 41 to 60 percent.
d. 61 to 80 percent.
e. 81 to 100 percent.

6. How has termination of social security coverage affected the employer's ability to attract new employees?

7. a. Are employees in your group aware of the 14.3 percent rise in social security benefits, effective June 1980?

b. In light of such social security benefit increases, do you believe your group would make the same choice about terminating social security coverage today?

C. Information on Alternate Income Protection Plans

1. a. Before social security coverage was terminated, was there any income protection plan in addition to social security for employees in your group?

b. If yes, was this additional plan modified or expanded when social security coverage was dropped?

2. Does your group now have an income protection plan? If yes, please answer questions 3–11.

3. a. What is the cost of this plan (this may be expressed as a dollar amount or a percent of wages) to:
(1) The employee.
(2) The employer.

b. How is this income protection plan financed (check one):
(1) *Advance funding* (the full value of the benefits to be paid to a retiree are collected by the time of retirement).
(2) *Terminal funding* (at the time of retirement the full amount of benefits expected to be paid to that retiree are set aside).
(3) *Pay-as-you-go* (the fund collects only enough to cover the benefits currently payable).

(4) *Other* (please describe).

4. How many of the following kinds of benefits are payable under the alternate plan, what are the eligibility criteria for each type of benefit, and how are the benefits computed? If a particular type of benefit is not offered, indicate "Not offered" next to benefit.

For example: a. Retirement benefits—payable at age 60 for full-time employees with 30 years service, or at age 65 with 20 years service; monthly benefit equals 2 percent of monthly salary multiplied by number of years of service.

a. Retirement benefits.

b. Disability benefits (please include definition of disability under the plan).

c. Survivor benefit for spouse (specify if payable to both widows and widowers).

d. Survivor benefit for dependent children.

e. Health insurance.

f. Describe any other benefits offered under the plan.

5. a. Are benefits from the plan reduced to take account of social security benefits?

b. If yes, specify how reduction is computed.

6. Does the employer guarantee payment of benefits to which employees become entitled?

7. Can funds from the current income protection plan be borrowed by the State or local government?

8. a. Are benefits under this plan adjusted for inflation?

b. If yes, is this adjustment automatic?

c. How often are benefits adjusted?

d. Is this a full cost-of-living adjustment? If not, please describe.

e. Is there a ceiling on how much of an adjustment can be made each year? If yes, what is that ceiling?

f. If an adjustment is made only if inflation is above a certain percent each year, what is that percent?

9. a. How many employees have become entitled to benefits under the alternate plan since social security coverage was terminated?

b. What is the average monthly benefit amount they receive from the alternate plan?

c. How many of these employees are also receiving a social security benefit?

10. a. At the time termination was being considered, was a study done to determine the value (in terms of costs and benefits) of the alternate plan compared to the cost and value of social security?

b. If yes, how did that study affect the group's decision to terminate social security coverage?

c. What were the major findings of the study?

d. What was the cost of the study?

e. Who performed the study? (Please give name and address of individual or company; if available, also give phone number.)

11. a. Do you believe that employees in your group are satisfied with the income protection plan they have now?

b. What, if any, concerns do employees have about their current income protection plan?

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Appendix 2

RESPONSES TO QUESTIONNAIRE

NOTE: Footnotes appear at end of tables.

1

SURVEY RESULTS

GROUP 1/	WHY GROUP CONSIDERED TERMINATING SOCIAL SECURITY COVERAGE								
	Cost/ Solvency	Seeking Better Investment	Has SS 2/ Coverage As A Dependent	Merged With Non-covered Group	Joined PERS	Disadvan-tageous Offset	State Refuses To Pay Employer Share	Opposes Welfare Add-ons	Other
CATEGORY I									
1	X								
2				X					
3	X					X			
4					X				
5						X			
6	X								
7	X								
8	X								
9					X				
10	X								
CATEGORY II									
11	X								
12			X						
13	X								
14	X								
15	X								
16	X								
17	X								
18	X								
19	X								
20	X								X
21	X								
22	X								
23	X								
24	X								
CATEGORY III									
25		X							
26		X							
27	X	X							
28		X	X						
29	X	X							
30	X								
31		X							
32	X								
33	X		X						
34	X								
35	X								
36	X							X	
37	X								
38							X		

2

GROUP	Where Idea to Terminate Originated			Opportunity to Vote		Outcome of Vote	
	Employee	Employer	Mutual	Yes	No	Terminate	Not Terminate
CATEGORY I							
1	X			X		X	
2							
3		X		X		X	
4	X			X		X	
5							
6	X			X		X	
7							
8		X		X		X	
9	X			X		X	
10							
CATEGORY II							
11			X	X			X
12	X			X			X
13		X		X			X
14		X		X			X
15	X				X		
16		X		X			X
17		X		X			X
18		X			X		
19		X		X			X
20	X				X		
21	X			X			X
22		X			X		
23		X			X		
24		X			X		
CATEGORY III							
25	X			X		X	
26	X			X		X	
27	X			X 3/			
28	X			X 3/			
29		X		X 3/			
30	X			X		X	
31	X			X		X	
32		X		X		X	
33	X			X		X	
34			X	X 3/			
35							
36			X				
37	X			X 3/			
38		X			X		

GROUP	REASONS FOR VOTE OUTCOME								
	TERMINATE					NOT TERMINATE			
	Cost/ Solvency	Seeking Better Investment	Disadvantageous Offset	Unfavorable Publicity	Employees Already Insured for SS	SS is Better Protection	Some Employees Ineligible for Alternate Coverage	SS Seen as Necessary National Policy	Portability
CATEGORY I									
1	X								
2									
3			X						
4	X								
5									
6	X								
7									
8				X					
9									
10									
CATEGORY II									
11								X	X
12			—			X			
13						X			
14						X			
15									
16						X			
17						X			
18									
19									
20									
21							X		
22									
23									
24									
CATEGORY III									
25		X							
26	X	X							
27									
28									
29									
30		X							
31	X								
32					X				
33									
34									
35									
36									
37									
38									

GROUP	REASON FOR WITHDRAWING NOTICE				DISCUSSED TERMINATION WITH SSA		WAS SSA HELPFUL?			DISCUSSED TERMINATION WITH STATE ADMINISTRATOR	
	SS Seen as Better Protection	Congress Improved Financing	Employee Desire To Remain	PERS Tied To SS	Yes	No	Yes	Fairly	No	Yes	No
CATEGORY I											
1					X		X			X	
2											
3					X		X				X
4						X				X	
5											
6					X		X			X	
7											
8					X				X		X
9					X		X				X
10											
CATEGORY II											
11			X							X	
12		—	X			—					X
13	X									X	
14	X				X		X			X	
15	X			X	X		X			X	
16	X				X			X		X	
17	X				X		X				X
18	X				X		X				X
19			X		X		X			X	
20	X		X		X		X			X	
21			X		X		X			X	
22			X		X		X			X	
23			X		X		X				X
24		X				X					X
CATEGORY III											
25					X		X			X	
26					X		X			X	
27					X			X		X 4/	
28					X 4/					X	
29					X 4/					X	
30					X			X		X 4/	
31					X			X			X
32					X 4/						
33					X		X			X	
34					X		X			X	
35											
36					X 4/						
37					X 4/					X 4/	
38					X		X			X	

GROUP	INFORMATION SOUGHT FROM SSA/STATE SOCIAL SECURITY ADMINISTRATORS 5/								
	Benefits/ Costs	Arguments For Coverage	Termination Procedure	Verification of Conclusions	Special Assistance	Impact On Employee	Comparison with Other System	Plans To Improve SS	None
CATEGORY I									
1	X								
2									
3				X					
4	X						X		
5									
6		X				X			
7									
8									
9									
10									
CATEGORY II									
11		X	X						
12			X						
13		X							
14		X	X						
15	X								
16							X		
17	X								
18		X							
19		X							
20	X	X	X			X			
21					X				
22	X								
23						X			
24									
CATEGORY III									
25								X	
26									X
27	X								
28	X						X		
29									
30	X						X		
31									
32		X							
33									X
34									
35									
36									
37	X						X		
38									

6

GROUP	EFFECT OF INFORMATION FROM SSA/ STATE ADMINISTRATOR ON GROUP DECISION				DISCUSSED TERMINATION WITH OTHER GROUPS	
	Convinced Not To Terminate	Convinced Many Employees But Not Enough Not To Terminate	Convinced To Terminate	No Effect	Yes	No
CATEGORY I						
1		X			X	
2						
3			X		X	
4				X		X
5						
6				X		X
7						
8						X
9						X
10						
CATEGORY II						
11				X	X	
12				X		X
13	X					X
14	X				X	
15	X					X
16	X				X	
17	X				X	
18	X				X	
19					X	
20	X				X	
21	X				X	
22	X				X	
23	X					X
24						X
CATEGORY III						
25				X	X	
26						X
27						X
28					X	
29						X
30				X	X	
31				X	X	
32				X		X
33					X	
34				X	X	
35						
36						
37					X	
38						X

7

GROUP	INFORMATION SOUGHT FROM OTHER GROUPS				EFFECT OF INFORMATION FROM OTHER GROUPS ON GROUP DECISION		
	Reasons For Termination	Information On Current Protection	Group Experience	Termination Procedures	Strengthened Desire To Terminate	Weakened Desire To Terminate	No Effect
CATEGORY I							
1	X	X				X	
2							
3			X		X		
4							
5							
6							
7							
8							
9							
10							
CATEGORY II							
11			X				
12							
13							
14	X						
15							
16			X				X
17			X			X	
18	X		X				X
19		X	X				
20			X				X
21		X					X
22	X					X	
23							
24							
CATEGORY III							
25		X		X	X		
26							
27							
28	X	X					
29							
30		X					
31				X			X
32							X
33		X	X	X			
34			X	X			X
35							
36							
37		X	X				X
38							

8

GROUP	Number of Employees	AVERAGE AGE				AVERAGE ANNUAL SALARY					LENGTH OF SERVICE (in years)			
		20-30	31-40	41-50	50+	$10K	10-15K	15-20K	20-25K	25K+	1-5	6-10	11-15	16+
CATEGORY I														
1	34		X				X					X		
2														
3	24			X			X					X		
4	11		X					X				X		
5														
6	134		X					X				X		
7														
8	275		X				X						X	
9	17	X						X				X		
10														
CATEGORY II														
11	2,326		X					X				X		
12	2		—		X		X							X
13	55			X			X						X	
14	650		X				X					X		
15	52		X					X				X		
16	600		X				X					X		
17	190			X			X						X	
18	1,000			X					X			X		
19	11,725		X					X				X		
20	2,220		X				X					X		
21	3,000		X				X					X		
22	700			X				X				X		
23	4,900						X					X		
24	400		X				X				X			
CATEGORY III														
25	153		X					X				X		
26	22		X						X			X		
27	228		X						X			X		
28	76		X					X			X			
29	969		X				X						X	
30	800		X			X						X		
31	18		X					X				X		
32	23			X		X						X		
33	39			X			X					X		
34	24		X				X					X		
35														
36	20		X				X				X			
37	250		X					X					X	
38	83				X	X					X			

9

GROUP	PERCENT OF EMPLOYEES ELIGIBLE FOR SOCIAL SECURITY IN SPITE OF TERMINATION					14.3% RISE IN BENEFITS			
						AWARE		AFFECT	
	0-20	21-40	41-60	61-80	81-100	Yes	No	Yes	No
CATEGORY I									
1				X			X		X
2						X			
3					X	X			X
4				X					X
5									
6			X			X			X
7									
8		X				X			X
9	X								X
10									
CATEGORY II									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
CATEGORY III									
25						X			X
26						X			X
27						X		X	
28						X			X
29						X			X
30						X			X 6/
31						X			X 6/
32									X
33						X			X
34						X			X
35									
36									
37						X			X
38									

GROUP	IS OTHER COVERAGE AVAILABLE? 7/		WOULD OTHER PLAN BE MODIFIED? 7/		HOW IS PLAN FINANCED? 7/				ARE BENEFITS OFFSET FOR SS 7/	
	Yes	No	Yes	No	Advance Funded	Terminal Funding	Pay As You Go	Other	Yes	No
CATEGORY I										
1	X		X		X				X	
2										
3	X			X			X			X
4	X			X			X			X
5										
6	X		X					X		
7										
8	X		Made Voluntary							X
9	X									
10										
CATEGORY II										
11	X		X		X				X	
12		X	—	X						
13	X			X						
14	X		X		X					X
15	X			X	X					X
16	X			X	X				X	
17	X		X		X				X	
18		X						X		
19	X		X							X
20	X		X		X					X
21	X		X		X					X
22	X			X		X				X
23	X									X
24	X		X				X			X
CATEGORY III										
25	X		X				X			
26	X		X		X					
27	X		X		X					
28	X		X					X		
29	X		X							
30	X		X							
31		X	X							
32	X			X	X					
33	X		X				X			X
34		X								
35										
36	X						X			
37		X								
38	X			X						

11

	COST-OF-LIVING ADJUSTMENTS						
GROUP	Yes	No	Automatic	AD HOC	Full	Cap	How Often Adjusted?
CATEGORY I							
1	X		X			3%	Annually
2							
3	X		X				Unsure
4		X					
5							
6	X		X			2%	Annually
7							
8	X		X			X	Twice yearly
9							
10							
CATEGORY II							
11	X			X			No regular interval
12							
13							
14		X					
15	X			X			Only if governing board approves
16	X		X			2%	Annually
17	X		X			2%	Annually
18							
19	X		X			3%	Annually
20		X					
21	X			X	X		Annually - if approved
22		X					
23							
24		X					
CATEGORY III							
25		X					
26	X			X			Unsure
27	X		X			2%	Annually
28	X		X		X		When salary increases granted
29		X					Last COLA in 1975
30							
31							
32		X					
33	X			X		X	Every 4 years
34							
35							
36							
37							
38	X			X		X	No regular interval

12

GROUP	Does Employer Guarantee Payment of Benefits? 7/		Can Funds be Borrowed by Employer? 7/		Did/Will Group Perform Study?		Who Performed Study?	
	Yes	No	Yes	No	Yes	No	In-house	Private
CATEGORY I								
1				X	X		X	
2								
3		X		X	X		X	
4	X			X	X		X	
5								
6		X		X	X		PERS	
7								
8		X		X				
9						X		
10								
CATEGORY II								
11	X			X		X		
12		-	-			X		
13						X		-
14	X			X	X		X	
15	X			X		X		
16	X			X	X		X	
17	X		X		X		X	
18					X			X
19		X		X	X		X	
20	X			X		X		
21			X			X		
22	X			X		X		
23						X		
24				X		X		
CATEGORY III								
25	X			X	X			
26	X			X	X		X	
27	X			X	X			
28	X			X	X			
29	X			X	X			X
30				X	X			
31								
32	X		X					
33	X			X	X			X
34					X			
35								
36	X				X			
37								
38		X		X				

Footnotes for Tables

1/ Several groups in Category II (groups choosing to remain in the program) were originally in Category I or III, but then opted to rescind notice of termination.

2/ Throughout these charts, "social security" is abbreviated as "SS, and "the Social Security Administration" as "SSA".

3/ Although the vote has not been held yet, the group will be given the opportunity to vote on the issue.

4/ Although the group hasn't taken such action yet, it is planning to do so.

5/ These responses reflect information that has already been requested or will be requested when the groups contact SSA or the State Social Security Administrators.

6/ These groups stated that their awareness of this increase in benefits simply exacerbated their concern over the cost of the program.

7/ The responses here generally describe the plan that has replaced SS or will replace SS if the group actually terminates SS coverage. However, the groups in Category II are describing the plans that supplement, but do not replace, SS protection.

o