SOCIAL SECURITY

DEPARTMENT OF THE TREASURY 93 11613
WASHINGTON

February 3, 1993

INFORMATION

MEMORANDUM FOR SECRETARY BENTSEN

FROM: John Hambor, Senior Economist

Alicia Munnell
Assistant Secretary - Designate

SUBJECT: Social Security Cola Limitations

SUMMARY: Limiting or eliminating COLAs may well be a dead issue by this time, but, if not, the following may provide some additional ammunition for your already well-stocked arsenal.

Cutting the Social Security COLA can have significant consequences for specific segments of the elderly population. In particular, some of the oldest single women could be especially hard hit. Of those initially pushed under the poverty threshold by eliminating the 1994 COLA, about 37 percent will be single women over age 65. A permanent benefit differential would also be introduced between workers eligible for benefits prior to 1994 and those eligible in 1994 and later. The latter workers would have permanently higher benefits unless the benefit formula were adjusted to reduce benefits downward for that and all subsequent cohorts.

DISCUSSION

A Social Security beneficiary who is eligible for a cost-of-living (COLA) increase in January 1994, will receive accumulated benefit increases of 14.5 percent through 1998 under current law, as shown in Table 1. For two COLA reduction proposals similar to ones being considered by the Administration, the 5-year increase would be reduced to 11.1 percent if the COLA is eliminated for 1994, and to 9.0 percent if the COLA is reduced by one percentage point per year through 1998.

The major concern with such limitations in the Social Security COLA is the likely impact on the low-income elderly population. Because many retirees have income near the poverty line, a relatively modest, temporary slowdown in the growth of individual Social Security benefits can produce a significant increase in the number of elderly below the poverty line. In 1990, 14 percent of beneficiary family units age 65 and older were below the poverty line and another 8 percent had income between the poverty line and 125 percent of the poverty line. As you know, this has been discussed during deliberations over the deficit reduction package. There are, however, some less frequently considered distributional consequences that arise from limiting COLAs.

Effects on Different Family Types

There are major differences in the impact of a one-year COLA freeze on the poverty status of different types of elderly beneficiaries.

- o Two (or more)-person families would be affected least while female-headed, single-person families would be affected most. 66 percent of persons pushed below the poverty threshold are single.

- o Poverty rates for older beneficiaries will rise more than they would rise for younger beneficiaries. 46 percent of beneficiaries age 72 and over would be affected while 19 percent of those under age 60 would be affected.

- o The biggest effect on poverty rates from the COLA reductions would be felt by single females in the oldest age groups. Almost 40 percent of affected beneficiaries would be single females age 65 and over.

- o Most older beneficiaries are highly dependent on Social Security for their retirement income. In 1990:

  - -- 69 percent of recipients aged 75 or older received 50 percent or more of their income from social security.

  - -- 40 percent of recipients received 80 percent or more from Social Security.

  - -- Recipients between the ages of 65 and 74 are less dependent because they are more likely to have some work, but even for this group, 51 percent received 50 percent or more of their income from Social Security and 25 percent received 80 percent or more from Social Security.

Interaction with SSI

However, many elderly beneficiaries already below the poverty line will receive full increases if COLAs for means-tested programs, particularly SSI (welfare payments for the aged, blind and disabled), are exempted from the limitation. Under the rules of the SSI program, persons receiving both SSI and Social Security benefits would be paid full COLA increases on both their SSI and Social Security benefit because the SSI formula would automatically adjust to compensate for the reduced Social Security COLA.

If the COLA reduction scheme were modified so that lower income Social Security beneficiaries, marginally above the SSI eligibility threshold received a full COLA, substantially fewer beneficiaries would be pushed below the poverty line, depending on the amount of relief granted. Such schemes provide a full COLA adjustment for benefits up to an amount consistent with an income level that is equal to, or some fraction (often 25 percent) above, the poverty line. Either no COLA or a fraction of the full COLA is paid on amounts above the designated level. Such plans can be expected to produce smaller aggregate budget savings compared to the simpler limitation schemes.

Under this scheme, more beneficiaries could become eligible for relief if the COLA limitation is in effect for a multi-year period. This occurs because the poverty line is fully adjusted for annual CPI increases and, over time the distribution of Social Security benefits will tend to be compressed toward the poverty line from above.

Intercohort Effect

COLA cuts also lead to intercohort differences that have effects similar to the "notch" problem in reverse. Unless compensating changes are made in the initial benefit determination formula, permanent disparities in relative benefit levels will develop between different retirement-age cohorts. Under the existing benefit formula, workers who turn 62 in 1994 or later would be unaffected if the 1994 COLA were skipped and would be less affected if COLAs were partially reduced for a period of time.

A permanent differential would be created between the cohorts of workers who attain age 62 after 1993 and the cohorts that have attained age 62 prior to 1994. For example, if the wage index used to calculate initial benefits rises at 4 percent per year in 1994 and prices rise at 3 percent, eliminating the 3 percent COLA in 1994, means that newly eligible retirees with the same relative earnings history would receive benefits 4 percent higher than workers who became eligible in 1993. As shown in Table 2, the differential would have been only 1 percent had the COLA been paid in 1994. Table 2 also shows that the 4 percent differential is maintained in 1995 assuming prices again rise by 3 percent.

The only way to avoid this "reverse notch" is to adjust the initial benefit formula in proportion to the COLA reduction, i.e., reduce the benefit bracket rates by the amount of the COLA reduction, -- a permanent across the board benefit reduction. In the above example this would result in a 3 percent reduction in replacement rates -- roughly a 1 percentage drop in the 41 percent replacement rate for a worker earning an average wage throughout his or her working life.

Attachment

Table 1 - Cumulative Percentage Benefit Increase for an Individual, under Two COLA Reduction Plans

Calendar Year	*Current Law Annual COLA**	Cumulative Increase: *Current Law*	*Rescind 1994 COLA*	*COLA less 1 percent*
1994	3.0	3.0	0.0	2.0
1995	2.7	5.8	2.7	3.7
1996	2.7	8.6	5.5	5.5
1997	2.7	11.6	8.3	7.3
1998	2.6	14.5	11.1	9.0

* Based on Administration economic assumptions.

Table 2 - Cohort Effect on Benefits from Rescinding 1994 COLA

	Social Security PIA * (Normalized to 1993 Cohort) *1993*	*1994*	*1995*
Cohort turning 62 in 1993	100	103	106
No COLA in 1994	100	100	103
Cohort turning 62 in 1994		104	107

* Based on assumed annual wage growth of 4% and CPI growth of 3%.

2/14/93 93-117375

TO: Secretary Bentsen

FROM: Alan Cohen

Subject: Talking Points on Social Security and Entitlements Other than Health Care (for 4:30 NEC Meeting).

1) There is a 60-vote point-of-order in the Senate against any reconciliation bill which makes any change that affects the Social Security program. To avoid this point-of-order it would be necessary to have a separate vote on the Social Security proposal.

2) We can probably avoid the 60-vote point-of-order problem if we were to increase the taxation of benefits from 50% to 85% **and** earmark the **increment** for the Medicare Hospital Insurance Trust Fund rather than the Social Security Trust Fund.

3) If were also to lower the income thresholds below current law levels ($25,000 for individuals and $32,000 for couples), I am not sure we could pass the package even if this change were part of the total bill. But I believe that if we change the thresholds, we would need a **separate vote** to get around the 60-vote point-of-order, even if we wanted to earmark the new proceeds for Medicare.(Senator: if you would like I could explain to you the exact technical reason for this). If we have a separate vote, there is no chance that we would get the 60 votes to lower the thresholds.

4) I believe that if we delay or reduce COLAs for Social Security, the whole package would be jeopardized. In addition, the COLA change would have to be voted on separately to get around the 60-vote point-of-order. This would be politically suicidal. In the Senate in 1985, the Republicans voted to freeze COLAs and these votes were used to defeat incumbents in the 1986 election which led to the Senate changing hands in that year.

Finally, any COLA delay, freeze or reduction would reduce the incomes of 4 million elderly poor and near-poor individuals. If we tried to fix this problem, we run into the severe problem that Social Security does not have data on recipient's total income. We would have to use a proxy for income and this would lead to many cases of two individuals who have the same income being treated differently.

5) There are just three other items that I have a concern about:

a) Increasing assessments on dairy, sugar, peanuts etc, by 66%. If the goal is to achieve equity with the crops that receive deficiency payments, I do not believe that 66% is the right number; it is too high. The 66% was derived because OMB proposes to increase the non-eligible acres from 15% to 25% **for the crops**

subject to deficiency payments. It was argued that this is about a two-thirds increase. But the correct way to look at this is that the subsidy would be decreased from pertaining to 85% of the crop to 75% of the crop. This is a cut of between 10% and 15%. Therefore, we should increase the dairy and sugar and peanut assessments by 10-15%, not 66%.

b) Under current law, 100% of the closing costs for FHA loans can be included in the mortgage. OMB proposes to restrict the amount of closing costs that can be included to 57%. This would raise the up-front cost of a $90,000 mortgage by $846. I am not sure that this will fly politically.

c) OMB proposes to eliminate new sign-ups for the Department of Agriculture's Conservation Reserve program. Has anyone discussed this with Vice-President Gore?

93-124146

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

Very interesting a possible fall back position...

MEMORANDUM TO THE SECRETARY 7/27/93

From: Michael Levy

Re: The Politics of the Entitlement Review and Health Care Entitlement Cap

1. **Entitlement Review by Executive Order**

In response to a question you asked yesterday, I spoke to **Charlie Stenholm** about **the politics of the entitlement review.** Specifically, I asked him whether the Conservative Democratic Forum/Mainstream Forum votes would require an entitlement review **in the bill, or** would they settle for an **Executive Order** from the President. Charlie gave me the following answer, which he also conveyed to the President in a meeting this morning in the White House:

> Given that there is a Byrd Rule problem in the Senate, they would like **Senator Sasser** to raise the Byrd Rule on the floor. **They would then like it to go to a vote, understanding that the Republicans will kill it.** Nonetheless, they believe that it is imperative that the Republicans get the dubious credit they deserve. **Only at that point, will they accept an Executive Order as the appropriate route.** But it is imperative that the entire process play out first.

2. **Health Care Caps** or **Entitlement Caps (as part of health care reform)**

You also recall that we discussed the idea of coupling the executive order with a pledge **now** from the President to add health care caps (or perhaps a more sweeping entitlement cap) onto his health care package when the entire package is announced. The hope would be that he might be able to use this to get a vote from Danforth (doubtful), Nunn, Kerrey and Boren and shore up our position among conservatives in the House. Obviously, for Nunn the best way to package this is to make it like the Nunn-Domenici entitlement caps, broader in scope (but not really in effect) than mere health care caps.

I have attached a memo from Marina on the subject.

DEPARTMENT OF THE TREASURY
WASHINGTON

TO: Mike Levy
FROM: Marina
SUBJECT: Entitlement Cap Initiative
DATE: July 26, 1993

SUMMARY: Pursuant to your request, here is an approach to a commitment that might be both persuasive with conservative Democrats and palatable to liberal Democrats.

RECOMMENDATION: The seeds of a proposal such as the one described below appear in Putting People First. Moreover, if the President actually goes forward on this basis, in my view he will make development of the health care plan easier because he will have foreclosed some more costly options.

OPTIONS:

_____I'm interested, will raise with Secretary Bentsen and Deputy Secretary Altman

_____Generally interesting, revise per marginal notes

_____Dreadful proposal, pretend it never happened

_____Other:

DISCUSSION:

- First, the context in which entitlement caps should be discussed is the health care "global budget." As you know, it is the increasing cost of Medicare and Medicaid that cause the entitlement numbers to loom so large. Liberals will be able to live with a cap if the rhetoric is structured to suggest that the limit is, in effect, the global budget for public health care expenditures [another mechanism would apply to privately financed health plans].

- The relevant section of Putting People First can be found on page 108 -- where the President and Vice President Gore state the following:

  "...The health standards board [created by the health reform legislation] will establish an annual health budget for the nation to limit both public and private expenditures."

- Both CBO and the National Manufacturer's Association have produced studies on the issue of "cost shift" -- a phenomenon much feared by the business community. In brief, when public funding for health care is reduced, providers increase the prices they charge the private sector to make up for the lost public reimbursement. The point here is to advise Senators Nunn, Bryan, Deconcini, Boren, etc. that ratcheting down on Medicare and Medicaid in the absence of system wide [public <u>and</u> private] restraints will hurt the very small businesses they are anxious to protect.

- Therefore, the President could score points with both liberals and conservatives if he were to commit to monitor and report to Congress on growth in entitlement spending [aka Stenholm], and focus the attention of these Senators on the need to work together to forge a reasonable global budget as part of health care reform. The monitoring and reporting function can begin immediately through the regulatory and/or executive order process -- no legislative language is needed [a plus in this situation since legislative language would trigger a Byrd Rule point of order].

93-125065

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

INFORMATION

SEP 23 1993

MEMORANDUM FOR SECRETARY BENTSEN

FROM: Alicia Munnell AM
John Hambor

SUBJECT: Social Security as an Independent Agency - Info

Based on staff contact within the past two weeks, we have learned that Senator Moynihan is planning to hold a hearing on Social Security as an independent agency sometime during September. He is considering inviting Treasury to testify. Once the hearing takes place, his plan is to move the bill quickly out of the Finance Committee.

There are two twists of some interest. First, Senator Moynihan's staff expects that Secretary Shalala will resist the initiative because it would substantially reduce the size of HHS and they are hoping that you will be supportive of the Moynihan bill and encourage the President's support as well. You were the author of an independent agency proposal that passed the Finance Committee in 1991 and you co-sponsored Senator Moynihan's last bill, once he agreed to include a one-person agency head, as recommended by the Staats Commission, rather than a 3-person board, a position advocated by former Commissioner Bob Ball. The most recent House version included a 3-person board and there has been no indication that the House view has changed.

The second twist, which may or may not end up in the bill, is to use the Board of Trustees (somehow) to insure that HHS does not drag its feet in complying with the enacted legislation. This idea is still under staff discussion and Senator Moynihan has not been approached about adding such a proposal. Our reaction to this addition to the bill, if it occurs, should be considered very carefully. Depending on what is ultimately proposed, involving the Board of Trustees in the administration of the program could significantly change the legislated role of the Board as primarily a financial overseer and investment manager.

Edward S. Knight

94-133209

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

APR 26 1994

LMB

MEMORANDUM FOR SECRETAY BENTSEN

FROM: Alicia H. Munnell AHM
Assistant Secretary
for Economic Policy

SUBJECT: Rostenkowski Proposal to Eliminate Social Security Deficit

Summary

The attached shows the provisions of H.R. 4245, introduced by Chairman Rostenkowski, that would put the OASDI Trust Fund into long-run surplus. It includes estimates of the reduction in the long-term deficit attributable to each major provision. The bill continues a pattern of generally imposing deficit reduction toward the upper end of the income distribution. Indications are the bill will not be acted on this year and, further, it seems likely that Congressional action on the deficit would not occur until after the 1996 election.

Background

The proposal includes all the obvious candidates for benefit reductions: a small COLA cut next year, a future cut in replacement rates skewed disproportionately toward high earners, and an acceleration of the increase in the normal retirement age to 67. Trust fund income would be increased by subjecting more benefits to the income tax (fully implement the President's proposal to tax 85 percent of the benefits of high-income recipients) and raising the OASDI payroll tax rate, in two steps, in the future. It would also require newly hired State and local government workers to be covered under social security. The three income raisers make up about 70 percent of deficit reduction, with about 60 percent from the two rate increases alone. If enacted, the bill would put the OASDI Trust Fund in long-term surplus by 0.22 percent of payroll.

strong agree

These provisions seem sensible as packaged, and are virtually an exhaustive list of major candidates for reform within the context of the current program structure. Most are phased-in with sufficient lead time to allow informed retirement planning and their ramifications are well-known to students of social security. And, short of support for a major overhaul of the system via means-testing or some form of privatization, they are likely, with some differences in the details, to be similar to the package of proposals the Social Security Advisory Council will recommend:

Comment

At this stage, it may be better that the Administration not publicly embrace a proposal with a substantial payroll tax increase, although an increase is probably inevitable.

The proposed benefit reductions continue the pattern of overloading the highest earners and better-off beneficiaries with the lion's share of the cuts. At some point this approach will begin to erode support for the program among the upper middle-class and some middle-class workers. We should be careful not to go so far that radical program changes such as means-testing, begin to develop significant support. agree

For now, Rostenkowski has indicated he does not plan to act on the bill, but simply wants to open discussions on how to handle the long-term deficit and demonstrate that the sooner we act, the less we need to do. In that context, the bill dovetails nicely with the Social Security Board of Trustees request that the Advisory Council develop recommendations. They are likely to report sometime during 1995, probably later in the year rather than early. On that basis it appears most likely that any serious legislative consideration would not be underway until after the 1996 election.

Attachment

ROSTENKOWSKI PLAN - H.R.4245

(Estimated OASDI deficit reduction as a percent of payroll.)

Gradual (50-year) reduction in replacement rates beginning in 2003. Lowers second bracket rate and adds a third bracket.	0.64
-- Low earners unaffected.	
-- Average earners benefit reduced 8 percent by 2053 (about 3 or 4 replacement rate points).	
-- High earners benefit reduced 20 percent by 2053 (about 6 replacement rate points).	
Scheduled retirement age increase to 67 accelerated and fully in place for those turning 62 in 2011.	0.12
Reduce COLA by 0.5 percentage points in 1995.	0.01
85 percent of benefits above current (lowest) thresholds subject to income tax.	0.02
Cover new State and local government workers beginning on January 1, 1995.	0.21
Gradually increase OASDI payroll tax rate to 7.35 percent between 2020 and 2024, and to 8.15 percent between 2055 and 2058.	1.39
Interaction	-0.04
Total OASDI deficit reduction	**2.35**

Note - Estimated deficit in 1994 Report is 2.13 percent. This plan would put the combined OASDI Trust Fund into <u>long-term surplus</u> by 0.22 percent of payroll.

TREASURY CLEARANCE SHEET

NO. 94-133709
Date April 21, 1994

MEMORANDUM FOR: ☑ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☑ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☑ SPEECH
☐ TESTIMONY ☐ OTHER

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy
THROUGH:
SUBJECT: Rostenkowski proposal to eliminate Social Security Deficit

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John Hambor	JGH		Director, Office of Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham	RG	4/26	Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

☐ Review Officer Date

☐ Executive Secretary Date

DO F 80-02.1 (04/89)

135617

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

June 10, 1994

MEMORANDUM FOR SECRETARY BENTSEN

FROM: Alicia Munnell
Office of Economic Policy

SUBJECT: Your Meeting With Senator Moynihan on Health Reform and Independent Social Security Administration

<u>Date & Time</u> Monday, June 13, 5:00 PM

<u>Location</u> Russell Building, Room 464

PARTICIPANTS:

<u>Treasury</u> Lloyd Bentsen
Marina Weiss

Senator Moynihan
Senator Moynihan's Staff

BRIEFING: Talking Points on Social Security
Memo from Marina Weiss on Health Reform
Memo from Randy Hardock on PBGC

Meeting with Senator Moynihan : Independent SSA Issues

- As you know, I very strongly support a single-person SSA head at the ES-I level as in the Senate bill. I also recognize the importance of establishing a permanent, broad-based, expert advisory panel to provide independent advice on policy matters to the agency. We struggled with this when I was Chairman. I have some concern, however, that the Senate bill may create conflicts between the Commissioner and the advisory board to the detriment of effective policy making. For example:

  - I believe meeting at least 6 times per year is too often and could create a serious challenge to the authority of the SSA Commissioner. As boardmembers would be paid a retainer (about $30,000 annually), such frequent meetings could create the appearance of a sitting policy board.

  - As proposed, the advisory board's specific duties could become intrusive. The board would have the ability to bypass the SSA Commissioner and directly appeal to the President and the Congress on trust fund solvency issues. I think this could potentially conflict with the OASDI Board of Trustees as well.

  - I would like to modify the advisory board structure in the bill to one which provides a full range of views, including those of the Congress, without undermining the authority of the SSA Commissioner in the process. It should meet once a year and should include members chosen by the Congress. I am prepared to work closely with you to improve the advisory board while maintaining the principles we both agreed with when I was Chairman.

- I also don't like a proposal by HHS to expand the OASDI Board of Trustees to seven members in order to preserve the Secretary of Labor on the Board.

  - Their proposal increases the likelihood of politicizing the public members by assuring that one party would always have a majority, and creates a substantial difference between the make-up of the OASDI and Medicare Boards. Thus far, the two public member model (one from each party) has worked exceptionally well on both Boards.

  - Perhaps, if the SSA Commissioner has to be added to the OASDI Board, and it is also important to keep the Labor Secretary on the Board, the Commissioner could be added to the existing Board, creating a six-person OASDI Board of Trustees.

DEPARTMENT OF THE TREASURY
WASHINGTON

June 13, 1994

MEMORANDUM FOR SECRETARY BENTSEN

FROM: Marina L. Weiss

SUBJECT: Health Reform

ACTION FORCING EVENT: Meeting with Chairman Moynihan

BACKGROUND/ANALYSIS:

You are scheduled to meet with Chairman Moynihan today to discuss 3 issues: PBGC; Social Security Independent Agency; and Health Reform. Your briefing materials include talking points on the first two issues, the following is an update and suggested approach on health reform.

News since Friday: Senator Dole received extensive coverage in the Sunday press of a speech he made in Boston. The media reports he said he is prepared to do what is necessary to block enactment of an employer mandate -- including filibuster the health reform bill. He is also said to have made it clear that Republicans are willing to run on the issue of opposing employer mandates, thereby making the 1994 election something of a referendum on health reform.

Senator Breaux appeared on Meet the Press to deliver essentially the same message he gave you when you met before the Memorial Day recess. It is time to move forward; it is imperative that we all understand the need to compromise; voluntary efforts to reduce the number of uninsured should be tried before a mandate takes effect (triggers); and the Administration needs its first string in this, the fourth quarter of the game. Breaux twice mentioned you and Mack McClarty as key players. Breaux also revealed that there are not enough votes for an employer mandate in the Finance Committee.

Senator Breaux was followed on the program by Harold Ickes whose message was the current Administration posture -- universal coverage is the bottom line for the President, Congress is working through the legislative process and we should not intervene. Note, however, that when he was asked about the Breaux proposal, Ickes did not rule out a "hard" trigger as a way of achieving universal coverage. But he did not embrace it either.

David Gergen appeared on the David Brinkley show and was somewhat more flexible than Ickes regarding the Administration's views. He attempted to reframe the questions to focus on the need to achieve universal coverage, and in the process acknowledged that coverage might be phased in over time.

Purpose of the Meeting: As you know, your meeting with Chairman Moynihan is the first step of a multi-step strategy that was initially suggested by Senator Breaux and modified further when you met with Pat Griffin before the Memorial Day recess.

Your meeting with the Chairman is both a reconnaisance mission to help prepare the President for his meeting with Senators Moynihan and Packwood tomorrow morning at 11:30; and an opportunity for you to determine what kind of assistance you or others in the Administration might give the Chairman.

As we discussed on Friday, Lawrence O'Donnell reports that Chairman Moynihan feels "trapped" by the President's demand that any bill would have to include universal coverage to obtain the President's support. When he brandished a pen at his State of the Union address and said he would veto any bill that did not meet his bottom line, Chairman Moynihan (in O'Donnell's view) lost his ability to negotiate anything less than an employer mandate among Finance Committee Members. O'Donnell suggests that the same dynamic is at work in Chairman Dingell's Energy and Commerce Committee, where a little flexibility on the part of the White House would help.

Brief Outline of Chairman Moynihan's Mark:

- Insurance reform including age adjusted community rating

- Employer and individual mandate (employer with more than 20 employees pay 80% of average premium; employers of fewer than 20 can opt out of mandate but, if they do, must pay 1% payroll assessment if they have fewer than 11 employees, and 2% of payroll assessment if they have 11-20 employees)

- Subsidies for individuals and employers are included (families of up to $30,000 annual income). The subsidy scheme was designed by Senator Mitchell with help from the White House.

- Benefits include "parity" for mental health and coverage which is actuarially equivalent to the standard benefits package under the Federal Employees Health Benefits Plan(FEHBP)

- National Health Board is created within HHS to advise the Congress and President on improvements in the program

- Voluntary alliances are permitted from which firms of 500 or fewer employees may purchase coverage

- Employers of 50 or fewer and individuals may purchase their health insurance through the Federal Employees Health Benefits Plan at the same price as that paid by federal workers plus an administrative fee

- Cost containment assumes managed competition and includes target premiums; a cost commission to monitor compliance; fast track procedures for consideration of a mandate if the percent of insured does not reach 98.5% by the end of the year 2000. Also, subsidy costs would be controlled through an automatically triggered reduction in federal funding if costs exceeds projections. A fast track procedure to correct the underfunding allows Congress to act quickly, but if Congress fails to act, the default would be a reduction in the amount of funding for subsidies.

- Financing assumes cuts in Medicare and new revenues including a $2.00 tobacco tax; an increase in the handgun ammunition excise tax to 50% ($140m); a 1% of payroll assessment on firms of more than 500 employees; HI tax extended to all State and local employees; "recapture" of Medicare Part B subsidies for individuals with incomes above $90,000 and couples with incomes over $115,000; eliminating the exclusion for health benefits provided through flexible spending arrangements; a 2.5% premium assessment for academic health centers and medical education research; and payroll assessments on small firms that do not provide coverage.

- Limited long term care including a tax credit for the personal assistance and exclusion of certain accelerated death benefits from taxable income

- No Medicare drug benefit

- New trust funds are established to support medical research, education and health infrastructure (the latter is financed by a set-aside from the tobacco tax)

- States could establish single payer systems

- Several changes to the tax code relating to tax exempt hospitals, repeal of the tax-exempt bond cap for 501(c)(3) organizations, repeal special Blue Cross/Blue Shield deduction; limit tax exemption for HMO's to staff or dedicated group models; and impose certain peanlty excise taxes as intermediate sanctions on tax-exempt health care organizatiosn for transations involving private inurement

- 80% (not 100%) deduction for the self-employed

Possible Middle Ground: If Chairman Moynihan is indeed looking for a way to report a bill somewhat less aggressive than an immediate employer mandate, there are at least two alternative formulations he could consider: (1) a "hard trigger," and (2) a "soft trigger" with a "fast track" procedure for consideration of an employer mandate if a target rate of coverage is not met by some date certain. Senator Breaux has proposed the first alternative; Senator Packwood has given Chairman a written proposal on the second approach.

Immediate Next Steps: If, as O'Donnell suggests, the Chairman is looking for a signal from the Administration that it is willing for him to explore alternatives other than the immediate employer mandate, there are several ways that could be done. If you think it appropriate, you might want to encourage the Chairman to tell you what kind of signal he thinks he needs and how it might best be delivered. Here are some options:

1. At the Tuesday meeting with Senators Moynihan and Packwood, his staff indicates that Senator Packwood is prepared to tell the President that there are no votes for an employer mandate on his side of the Committee. Chairman Moynihan could then indicate that he and his Democratic Members would prefer a bipartisan bill, and would like the President's blessing to consider seriously a delayed employer mandate (trigger). The issue would then become whether or not the terms of this agreement would be reported to the press (the problem here is that the Ways and Means Committee is poised to vote on an employer mandate this week and an agreement of this nature may be read as a weakening of resolve on the President's part, thereby sending the wrong signal to skittish Ways and Means Democrats).

2. The President could listen to the report from the two Senators and then indicate that he would like to think about the situation and talk further with Chairman Moynihan before making a decision. I raise this option because the Chairman is said by O'Donnell to feel that he has been neglected by the White House, which continues to talk with the Leadership of both Houses as intermediaries to the Chairmen. This approach would also give Ways and Means some time to move without having to deal with the dislocation that a new signal from the President could cause.

3. The President could simply restate his bottom line, universal coverage, and reassure them that he is flexible on how it is achieved -- he could specifically remind them that his own bill includes a phase-in (begins in '96, everyone has some improvement in coverage by '98, but the bill is not fully implemented until 2004 -- note that some of the mental health, dental, and long term care benefits do not take effect until after the year 2000). While this approach would not require the President to affirmatively state his willingness to accept a trigger, he would have sent every possible signal without actually uttering the words. This morning's press reports of the Sunday talk show interviews with Ickes and Gergen conclude that the White House is willing to be flexible on the speed with which a mandate is implemented.

This is my prefered alternative because one can make the argument that the press is making more of the issue than is warranted. Specifically, the President's original plan proposes numerous phase-ins, including phased-in coverage for mental health, dental benefits, and long term care (fully implemented after the year 2000). So if the Finance Committee wishes to delay or phase-in the mandate, that would be consistent with the President's desire to move carefully and over time to full implementation.

Given that the press has already concluded we are willing to accept a delayed mandate, all that remains is for the White House to offer a rational explanation for our apparent change in position. (You should know, however, that there are vigorous debates going on among the White House health staff over whether or not to agree to consider a hard trigger. Even after Ickes and Gergen appeared on the Sunday shows, some in the White House are of the view that it was not the intention of the Administration to signal willingness to delay the mandate.)

4. Finally, the President could delegate responsibility for interacting with Chairman Moynihan and Senator Packwood, while holding out for himself final decision making authority. Under this approach, someone from the Administration who is trusted by the President and First Lady (as well as Chairman Moynihan) could engage in some "shuttle negotiating" on a draft package. This arrangement would provide the President some distance from the negotiating process, and protect his right to reject the draft plan since he would not have been a direct party to the compromises that were made in order to reach agreement.

In this latter model you are a logical intermediary, given your unique relationship with the Finance Committee and the Administration. But because the negotiator under this scenario would be taking a very significant risk that the President and First Lady would not embrace the draft plan, it might be preferable to have a small "team" handle the discussions. Under the team approach, I would recommend you, Director Panetta, and Secretary Shalala. Ira Magaziner would, of course, want to be a part of these consultations -- unfortunately, his relationship with Chairman Moynihan is somewhat strained. Therefore the process might be smoother if, at least initially, the meetings were between the Cabinet Members and the Chairman and Ranking Member.

If you like this model but think a 3 person team is too formal an arrangement at this stage of the process, you could start by suggesting that bipartisan discussions be conducted on a single issue (mandates, for example), to ascertain whether there is any possibility of moving forward together. Senators Moynihan and Packwood could sit down with the appropriate Administration representatives to see where there may be common ground.

Again, this approach carries some danger that House action will be slowed or that House Democratic Chairmen will resent the Administration's overtures to Republicans and want to be a part of the discourse. In my judgment, it would be difficult to include House Members in delicate bipartisan discussions because the debate in the House has been so partisan and acrimonious. Perhaps the only way to handle this problem is for Pat Griffin to give the House Chairmen and Leadership periodic briefings.

M E M O R A N D U M

TO: SECRETARY BENTSEN
FROM: RANDY HARDOCK AND HARLAN WELLER
DATE: MAY 24, 1994 RHH H.W.
RE: PBGC UPDATE

Last week we sent you the attached memorandum recommending that you speak with Chairman Moynihan about the importance of trying to deal with PBGC legislation this year. Since that memorandum was sent, we have been told that the Finance Committee intends to hold a full committee hearing on the PBGC issue in early June.

Despite the tentative scheduling of that hearing, we continue to recommend that you raise the PBGC issue with Senator Moynihan at an appropriate time. We have been pushing the Finance Committee staff for a hearing and had already been told that the Chairman had agreed to schedule one. The purpose of a conversation between you and Senator Moynihan would be to emphasize that the PBGC problems are considered significant at the highest levels of the Administration and that they should be dealt with this year, if at all possible. The hearing is only the next step in that process.

6/1/94
If he hasn't by his return on the 9th I will do so. A mistake to call him during the recess.
Lloyd

M E M O R A N D U M

TO: SECRETARY BENTSEN
FROM: RANDY HARDOCK AND HARLAN WELLER
DATE: MAY 20, 1994
RE: PENSION BENEFIT GUARANTY CORPORATION LEGISLATION

<u>SUMMARY</u> -- Last fall, the Administration submitted a Pension Benefit Guaranty Corporation (PBGC) bill. At a recent PBGC Board meeting you told PBGC Executive Director Slate that you would be willing to call Chairman Moynihan and let him know that this is an important initiative for the Administration. This memorandum provides background and talking points on that issue.

<u>RECOMMENDATION</u> -- That you either call Chairman Moynihan on this issue specifically or, if appropriate, mention this issue to him during any conversations you may be having over the next few weeks. One of the reasons Administration proposals on the PBGC made little progress in the past was that high ranking Bush Administration officials did not seem to care. We believe that raising this issue with Chairman Moynihan will send a signal that this issue is worthy of careful consideration by the Committee.

<u>DISCUSSION</u>

<u>Legislative Activity</u> -- Last year, the Administration created an interagency task force to examine the problems faced by the PBGC. The task force recommended legislation that would limit the PBGC's exposure over the long term. The "Retirement Protection Act of 1993" was submitted in September 1993, and was introduced last fall in the House by Chairmen Rostenkowski and Ford and in the Senate by Chairman Moynihan.

The full Ways and Means Committee held a hearing on April 19th. Secretary of Labor Reich and Assistant Secretary Samuels testified at that hearing. We have been told by staff that the Senate Finance Committee staff will hold a hearing on the topic in May or June.

<u>Description of Bill</u> -- The bill strengthens the PBGC's financial situation in several different ways. First, the bill would substantially increase plan funding by (i) strengthening Internal Revenue Code minimum funding rules for underfunded pension plans; (ii) eliminating loopholes that employers have legally used to minimize plan funding and (iii) repealing certain tax rules that make it difficult for sponsors of underfunded plans to fully fund their plans. Second, the bill increases the PBGC's ability to respond to certain corporate transactions that potentially increase the Federal government's exposure.

Talking Points

• I know the Finance Committee has a lot on its plate. We are pushing you on health care reform, GATT, welfare reform. You are interested in Social Security issues. That doesn't leave that much time for other, more mundane, good government issues.

• But there are some of those issues that we just can't afford to ignore completely. I just wanted to bring the Pension Benefit Guaranty Corporation issue to your attention. This is a problem that we have to nip in the bud.

• We set up a task force last year to look into this and they found that the problems at the PBGC were serious. Underfunding of pension plans went up from $38 billion to $52 billion just this year. The PBGC (and the Federal government standing behind it) could be on the hook for a lot of that money.

• Our proposal would require employers to do a better job of funding their pension benefits. I'm told you've asked your staff to set up a hearing on the PBGC. We thank you for that.

• I wanted to put this on your radar screen now because it's important that we deal with the PBGC issue this year, if at all possible. This is one of those thankless good government issues, but if we don't deal with soon it's just going to get tougher.

• Now is the time because:

* It's easier to ask companies to contribute more when the economy is going well;

* The problem is going to get worse and be all the tougher to deal with, maybe requiring taxpayer dollars;

* For the first time, we have something of a consensus that we need to do something. In the past, organized labor has fought the kind of changes we are proposing. But at a Ways & Means hearing the UAW said "they agreed with the Administration that there are longer term concerns that should be resolved now" and said that the Administration's approach of strengthening the funding rules "is the best way to address the problem".

* Jake Pickle has worked this issue in the House and it will be harder to get done after he retires.

• I don't know yet how we get it done this year. It's a tax bill and we don't have a vehicle for it yet. And these good government proposals don't have a built in constituency pushing them. But I just wanted you to know that we feel strongly that we should do something this year, if possible. I'd appreciate it if you could keep an open mind on so that we can act quickly if an opportunity arises.

DEPARTMENT OF THE TREASURY
WASHINGTON

94-134968

ASSISTANT SECRETARY

JUN - 9 1994

MEMORANDUM FOR SECRETARY BENTSEN

FROM: Alicia H. Munnell AHM
Assistant Secretary for
Economic Policy

SUBJECT: Organizational Structure of an Independent Social Security Administration

Date and Time: Friday, June 10, 1994, 11:00 a.m.

Location: Secretary's Office

PARTICIPANTS:

Treasury: Assistant Secretary Munnell
Deputy Assistant Secretary Weiss
John C. Hambor, Director, Office of Policy Analysis

BRIEFING: Overview

Organizational Structure of an Independent Social Security Administration

Issue

As part of the normal process of relaying the Administration's views, Treasury is currently drafting a letter to the conference on H.R. 4277, the Social Security independent agency bill. Two issues in the bill relate to the structure of the new agency that affect the OASDI Board of Trustees. We thought they should be brought to your attention.

(1) Should Treasury object to a proposal by HHS to expand the OASDI Board of Trustees to seven members to preserve the Secretary of Labor on the Board?

(2) Should Treasury object to the 7-member policy advisory board as proposed in the Senate version of the bill?

(1) Structure of the OASDI Board of Trustees

Background

Both the House and Senate versions will remove the Labor Secretary from the OASDI Board of Trustees and replace the Secretary with the SSA Commissioner. The House version also substitutes the Chair of its three-person Social Security Board for the Treasury Secretary as OASDI Board chairperson. HHS, in their draft of the conference letter, has proposed adding the SSA Commissioner and a third Public Trustee to the board and not removing the Labor Secretary. The three alternative structures are compared with the current structure below.

Alternative OASDI Board Structures

Current(5)	Senate Version(5)	House Version(7)	HHS Alternative(7)
Treasury, Chair	Treasury, Chair	SSA Board Chair, Chair	Treasury, Chair
Labor	SSA Commissioner	SSA Boardmembers(2)	Labor
HHS	HHS	Treasury	HHS
Public Members(2)	Public Members(2)	HHS	SSA Commissioner
		Public Members(2)	Public Members(3)

Although it is generally expected that the House structure will not be adopted, we should strongly object to removing the Treasury Secretary as OASDI Board Chairperson. Further, we think the HHS structure would increase the likelihood of politicizing the public members by assuring that one party would always have a majority. Thus far, the two public member model (one from each party) has worked exceptionally well. Therefore, we should disagree with the HHS structure. If the SSA Commissioner has to be on the board, the preferred alternative is to add the Commissioner, creating a six-person Board.

Suggested Text for Conference Letter

The Treasury Department disagrees strongly with the House provision that removes the Treasury Secretary from the Chair of the OASDI Board of Trustees. Although the Secretary's role as Managing Trustee would not be affected, his removal from the Chair would jeopardize Treasury's ability to influence the quality and content of the analysis underlying the annual report on the financial condition of the combined OASDI Trust Fund. The loss of prestige associated with the Board being chaired by a non-Cabinet member could diminish the Board's historically influential role in evaluating the financial status of the program. Further, Treasury does not support expanding the OASDI Board of Trustees from five to seven members as proposed in the draft report. Expanding the Board by adding a third Public Trustee to maintain an uneven number of Board members is an impractical response to provisions that remove the Labor Secretary from the Board. Adding a third Public Trustee increases the likelihood of politicizing the public members and creates a substantial difference between the OASDI and Medicare Boards. We prefer adding the Social Security Commissioner to create a six-member Board.

(2) Policy Advisory Board

Background

The Senate version includes a 7-person advisory board consisting of three persons chosen by the President (two from one party), two by the Senate (one from each party), and two by the House (one from each party). They would be required to meet at least 6 times per year, creating what could become a continual challenge to the authority of the Commissioner. The very useful tradition of a quadrennial OASDI Advisory Council would be abolished.

As structured, the advisory board's specific duties are intrusive and the board would have the power to bypass the Social Security Commissioner and appeal directly to the President and the Congress on solvency issues. Our view is that the advisory board should be dropped and replaced with a revamped OASDI Advisory Council, which would provide a full range of informed views without undermining the authority of the Social Security Commissioner in the process.

Suggested Text for Conference Letter

Treasury supports very strongly a single-person SSA head at the ES-I level. We also recognize the importance of establishing a permanent, broad-based, expert advisory panel to provide independent advice on policy matters to the agency. We are concerned, however, that the Senate proposal, as currently structured, may create conflicts between the Commissioner and the advisory board to the detriment of effective policy making. Treasury is prepared to work with the Conference Committee to fashion an improved advisory mechanism that satisfies the need for institutionalized, bi-partisan, expert advice on OASDI policy issues.

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

NOV 14 1994

INFORMATION

MEMORANDUM FOR SECRETARY BENTSEN
DEPUTY SECRETARY NEWMAN

FROM: Alicia H. Munnell
Assistant Secretary
for Economic Policy

SUBJECT: Raising the Social Security Retirement Age

SUMMARY:

Raising the normal social security retirement age is being discussed widely as an easily defensible change to the social security program that will help close the long-term deficit. The problem is that extending the normal retirement age does not change the age at which benefits first become available -- age 62 -- it merely cuts benefits. Those most affected by the cuts are workers in relatively poor health and those who have worked many years in physically demanding occupations. These workers tend to retire early and thus, would receive a disproportionately large benefit cut. Across-the-broad cuts in replacement rates, which would affect all workers proportionately, are a better way to lower benefit costs.

DISCUSSION:

Under present law, the normal retirement age (NRA) for receipt of full social security benefits, currently 65, is scheduled to rise to 67 in two stages. An NRA of 66 will be in place for cohorts becoming eligible for benefits (attaining age 62) in 2004 and, after remaining unchanged until 2017, will be fully phased-in to age 67 for workers attaining age 62 in 2022.

Proposals to change the NRA fall into two categories: increasing the NRA beyond 67 (usually to 70) and accelerating the phase-in of the scheduled increase to 67. On the surface, such proposals appear to be natural adjustments to the increases in life expectancies since the program's inception in the 1930s, but in fact, extending the retirement age is a benefit cut for the most vulnerable workers.

Proposals to increase the retirement age substantially reduce the projected long term deficit in the social security trust fund. Raising the NRA to 70, for example, cuts the long-term deficit roughly in half. But unless the phase-in is very rapid, and thus, potentially disruptive to retirement planning, changing the NRA creates little or no budget saving in the short term.

EXECUTIVE SECRETARIAT

Raising the NRA

Raising the retirement age is really a cut in benefits. That is, benefits would be lower at all potential retirement ages because of the rise in the age at which full benefits would be paid. For example, under a bill introduced by Congressman Pickle (H.R. 3585), which increases the NRA to age 70, a worker retiring at 62, once the change is fully in place, would receive only 60 percent of full benefits, compared to 70 percent for a worker retiring at age 62 when the currently scheduled increase to age 67 is fully phased-in, and 80 percent for a worker retiring at age 62 today. Currently, about half of eligible 62-year old workers take benefits at age 62, and almost 60 percent of new retirees are age 62.

The benefit cuts for early retirees will disproportionately affect retirees who are in relatively poor health and have worked in physically demanding occupations the largest share of their work lives. These groups tend to retire earlier and to have lower incomes. Included, for example, would be laborers, nursing aids and orderlies, janitors and cleaning workers, farm workers, construction workers, and others who believe they are physically unable to continue working but are ineligible for social security disability benefits.

Based on a 1986 study by SSA, this group comprises as much as 30 percent of all new retirees, and further, their average income is only about 75 percent of the average income for the remainder of retirees. And social security benefits are particularly important to this affected group. About 30 percent of new retirees in the affected group are in the lowest quintile of the income distribution compared to about 15 percent of the unaffected group. Social security benefits account for almost 80 percent income for all new retirees in the bottom quintile of the income distribution.

In addition, it is sometimes argued that by raising the NRA many older workers would remain in the workforce longer and partly offset the effects of slower labor force growth anticipated in the late 1990s. However, the bulk of the empirical analysis of the effect of changes in social security retirement provisions on labor force participation by the elderly suggests such an effect is unlikely to be very large.

Accelerating the Current Law Phase-in

The current phase-in pattern (to age 67) was arbitrary in that the operative constraint was to achieve a given amount of long-term OASDI deficit reduction as part of the bi-partisan agreement on the 1983 Social Security Amendments. Accelerating the current law increase or quickly phasing in a higher NRA is the current law increase or quickly phasing in a higher NRA is one way to generate some near term budget saving from social security. However, a phase-in fast enough to create short-term budget saving would be disruptive to many older workers because they would have little time to accumulate additional resources to offset reduced benefits.

TREASURY CLEARANCE SHEET

NO. 94-139647

Date November 7, 1994

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy

THROUGH: ______

SUBJECT: Raising the Social Security Retirement Age

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John Hambor	JH	11/8	Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham	RG	11/10	Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

NOV 22 1994

MEMORANDUM FOR DEPUTY SECRETARY NEWMAN

FROM: Alicia H. Munnell (Initialed)
Assistant Secretary
for Economic Policy

SUBJECT: Your Comment on the Social Security Retirement Age

The point of the retirement-age memo was that raising the normal retirement age is a benefit cut that disproportionately affects workers who are less able to continue working due to less-than-disabling physical limitations, often because of long years of work in physically demanding jobs. Rather than cut retirement benefits in a manner that penalizes such workers, it would be better to cut benefits across the board by lowering the initial replacement rate (initial benefit as a percent of pre-retirement earnings) for all new retirees. In fact, if, as some have argued, life expectancy is positively correlated with income, a case could be made for relatively larger cuts for high-wage workers. In my judgement, that would be overkill and unnecessarily increase the progressivity of the benefit structure. An across-the-board cut, which lowers the initial replacement rate for all workers (currently about 41 percent of pre-retirement earnings for the average worker), would affect workers at all earnings levels proportionately and not single out workers who are less able to continue working to avoid a benefit cut.

At the end of the day, it is very likely that resolution of the long-term social security financing problem will include an increase in the normal retirement age as part of the solution. However, as the change is being considered, it is worth keeping in mind that added years of life expectancy do not easily and automatically translate into additional years in the work force for many older workers. Further, we should remember whose benefits will be cut and perhaps consider a targeted liberalization of the existing disability program to redress any inequities.

TREASURY CLEARANCE SHEET

NO. 94-139918
Date November 22, 1994

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy
THROUGH: ______
SUBJECT: Your comment on the Social Security Retirement Age

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John Hambor	JA	11/22	Director, Office of Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham			Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

DEC 12 1994

MEMORANDUM FOR SECRETARY BENTSEN
DEPUTY SECRETARY NEWMAN

FROM: Alicia H. Munnell
Assistant Secretary
for Economic Policy

SUBJECT: Social Security Cuts in Kerrey-Danforth Proposal

SUMMARY:

The Kerrey-Danforth preferred option, released on Friday, is overly draconian with respect to social security cuts. This is largely the result of including a proposal to reduce payroll taxes by 1.5 percentage points on a voluntary basis and overadjusting for the Commission's estimate of the resulting large revenue loss over the next seventy-five years. A smaller package of cuts will eliminate the long-run trust fund imbalance, and, if combined with a small future payroll tax rate increase (not included in the Kerrey-Danforth proposals), an even smaller package of cuts would suffice.

Kerrey-Danforth Social Security Cuts

The Kerrey-Danforth proposal (Package 1 in attached table) cuts social security about 90 percent more than necessary to eliminate the long-term social security deficit of 2.13 percent of payroll. About two-thirds of the excess is needed to finance a payroll tax cut of 1.5 percentage points included as a voluntary option. By itself, the remainder would produce a long-run actuarial surplus in the program. Alternative options (Package 2 and 3 in table) are considerably less destructive of the social security program and achieve long-run actuarial balance. They rely on raising the retirement age, adding a bracket to the benefit formula for high-wage retirees, and an adjustment to the CPI. They are roughly similar to the benefit cuts in the Rostenkowski plan, but do not include a payroll tax cut. If combined with a small future payroll tax rate increase, the benefit cuts could be moderated a little more. Such an outcome is not unreasonable and is likely to be in the mold of the recommendations of the Quadrennial Social Security Advisory Council, which is expected to report sometime next year.

Replacement Rates in Package 1

On Sunday, on the Brinkley show, Secretary Bentsen used the reduction in the average replacement rate for a social security beneficiary from about 40 percent to 24 percent of preretirement earnings to characterize the size of the benefit cuts included in the Kerrey-Danforth entitlement proposal. Those numbers represented our first rough estimate of the effects of their proposal and were in a memo you saw on Thursday, December 8. Attached is a more detailed update of the effects of Kerrey-Danforth on social security replacement rates in the form of a Q and A. The replacement rate reduction consistent with the Secretary's comment is for a 67-year-old (the current law normal retirement age) who has average earnings, once Kerrey-Danforth is fully phased-in in 2056 -- a reduction from 42 percent to 23 percent of preretirement earnings.

Attachments

Social Security Provisions in Kerrey-Danforth Proposals

(Percent of Long-term OASDI Deficit*)

Provision	*Package 1*	*Package 2*	*Package 3*
Benefit Cuts			
Raise Retirement Age to 68	—	24.2	—
Raise Retirement Age to 70	47.9	—	47.9
Index "Bend Points" by CPI	72.3	—	—
Add Third Bend Point	28.6	28.6	28.6
Reduce Spousal Benefit	—	8.0	—
COLAs			
Adjust CPI to Better Reflect Inflation	32.9	32.9	32.9
Payroll Taxes			
1.5 Percentage Point Payroll Tax Reduction	-57.0	—	—
Cover State and Local Workers	6.6	6.6	6.6
Total	***131.3***	***100.3***	***116.0***

Source: Entitlement Commission estimates.

* Long-term OASDI deficit was 2.13 percent of payroll in 1994 Social Security Trustees Report.

Office of Economic Policy
December 12, 1994

Social Security Benefit Cuts

Question:

The Kerrey-Danforth "mark" includes significant cuts to social security benefits, perhaps as much as 50 percent. Do you think social security cuts of this magnitude should be used to help control entitlement spending?

Answer:

No, because its not necessary. The social security financing problem is long-term and can be solved by relatively modest benefit cuts and a small payroll tax increase if we act within the next few years. The Quadrennial Advisory Council is currently deliberating on social security's long-term financial problems and will be making recommendations to the Administration sometime next summer.

We should also remember that, with benefit cuts of the size recommended by the Commission mark, the SSI program for low income elderly will come under increased pressure at the same time that Kerrey-Danforth calls for across-the-board cuts in other entitlements, including SSI.

Background

The Kerrey-Danforth proposal changes the social security benefit formula while raising the normal retirement age to 70. For workers retiring at age 67 (when fully phased-in in 2056) it results in roughly:

- o a 50 percent decline in benefits for workers earning the taxable maximum (replacement rate falls from 28 percent to 14 percent),
- o a 45 percent decline for workers earning the average wage (replacement rate falls from 42 percent to 23 percent),
- o and a 33 percent decline for low-wage workers (replacement rate falls from 56 percent to 37 percent).

Office of Economic Policy
December 9, 1994

95-147364

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

JUN 22 1995

To: Alicia Munnell
From: Bob Rubin

INFORMATION

Strikes me as a dubious idea, at best.

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN
UNDER SECRETARY SUMMERS

From: Alicia H. Munnell AHM

Subject: Investing the Social Security Trust Fund in Equities - An Upcoming Issue for Treasury

While the Quadrennial Social Security Council was to release its report in July, current indications suggest their recommendations will not be released before September, at the earliest. Despite the delay, it may be worthwhile giving some consideration now to the expected proposals. One in particular -- allowing the OASDI Trust Fund to be partially invested in equities -- could require a Treasury reaction. First, changing the investment options for social security could move the balanced budget debate toward focusing on the non-social security budget rather than the unified budget. Second, it would present Treasury with thorny implementation issues if the recommendation is ever enacted into law.

The rationale for changing trust fund investment policy is for the fund to earn a higher return on invested assets, which are now required to be held only in Federal or Federally guaranteed instruments. The Trustees' current assumption is that the government rate will be 6.3 percent over the 75-year projection period which, given their inflation assumption of 4 percent per year, translates into a projected real rate of 2.3 percent. In contrast, a 5 to 6 percent real return appears to be a reasonable long-term projection for equities. Each 50 basis points of higher interest return would reduce the long-term deficit by about 0.3 percent of payroll.

<u>Bosworth Proposal</u>

Much of the interest in changing trust fund investment practices is based on a paper by Barry Bosworth of the Brookings Institution. He argues that given the low (roughly 1 percent) implicit real rate of return on social security contributions paid by today's workers, it would make sense to invest the trust fund (which only partially funds their retirement) in a manner that captures a higher return than will be realized by investing only at the government rate. His proposal is predicated on quickly raising the size of the trust fund by closing the long-term deficit through an immediate payroll tax increase or perhaps a combination of a payroll tax increase and benefit cuts that

EXECUTIVE SECRETARIAT

will produce immediate savings. He argues this increment to the trust fund would add to national saving where it would be used to finance new capital investments leading to a higher level of output in the future. The income earned from the new capital "belongs" to the trust fund and should be used to pay benefits when today's workers retire because they financed the increased investment.

Note the desired result of more capital and thus, higher economic growth, depends on two outcomes, which many think are problematic. First, the trust fund must be increased by a lot, and fairly quickly. Either a payroll tax increase or a combination of a payroll tax increase and benefit cuts that have an immediate effect on the trust fund would have to be enacted soon. And second, the increased trust fund surpluses resulting from such a policy must be translated into higher national saving. The presumption is that the surpluses will not be used to finance the current budget deficit. As a result, the need to borrow more from the public because of the new investment policy will put sufficient pressure on the Executive and the Congress to lower or eliminate the <u>non-social security</u> deficit. However:

- Raising payroll taxes, even a little, and even if good public policy, is not likely to occur as long as the current anti-tax increase climate persists.
- Cutting benefits (probably COLAs) to have maximum short-term impact is also very unpopular politically.
- Eliminating the non-social security deficit is an even bigger job. Shifting the budget debate from overall balance to balancing the non-social security budget raises the amount of deficit reduction required to achieve balance.

<u>Other Concerns</u>

- Without increased saving, the case for investing in the stock market is much weaker. In that case the only effect is to restructure investment portfolios so that the public ends up holding more government debt and the Federal government (via social security trust funds) holds some equities. The result is an increase in the return on government holdings and a decrease in the return on the holdings of the public. This is, in effect, an indirect tax on private sector investors.
- The Federal government would assume the risk associated with holding equities. In particular, this could require the government to sell in a down market if trust fund assets are needed to pay benefits once the trust fund is in cash flow deficit (beginning in 2013, under current financing provisions). It could result in lower benefits or higher

taxes to replace losses from forced liquidation of trust fund holdings.

- A host of implementation issues would have to be addressed. The Office of the Fiscal Assistant Secretary, which would likely be charged with implementing such an investment policy unless Fund management is turned over to an independent board or the independent Social Security Administration, is very concerned.

The Secretary of the Treasury

June 23, 1995

NOTE FOR ALICIA MUNNELL

FROM: BOB RUBIN

Strikes me as a dubious idea, at best.

Attachment

TREASURY CLEARANCE SHEET

NO. 95-147364
Date 6/22/95

MEMORANDUM FOR: ☒ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Alicia Munnell
THROUGH: ______
SUBJECT: Investing the Social Security Trust Fund in Equities - An Upcoming Issue for Treasury

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for International Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John Hambor	JH	6/22/95	Director, Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham			Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______ ☐ Executive Secretary ______ Date ______

11 8743

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

AUG 7 1995

To: Alicia Munnell
fr: Bob R

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY NEWMAN
UNDER SECRETARY SUMMERS

INFORMATION

From: Alicia H. Munnell

Subject: Social Security Advisory Council - Update

December 1995 could make this a difficult event to deal with.

Summary

The Advisory Council is developing recommendations to resolve the 75-year OASDI Trust Fund deficit (estimated to be 2.17 percent of payroll in the 1995 Trustees' Report). Two factions (perhaps a 7-6 split among the Council's 13 members) with different approaches have emerged in the deliberations to date. A first draft of the report is expected to be ready sometime in late September, with a final report not likely to be sent to the Secretary of HHS until December. Treasury should invite the Council to provide a briefing once the report is released and the administration should treat the report as the start of a detailed discussion which will ultimately lead to a proposal to modify the system.

Advisory Council Recommendations

The two factions are represented by the "Ball Plan" and the "Gramlich Plan," reflecting positions primarily associated with former Social Security Commissioner Bob Ball and Advisory Council Chair Ned Gramlich. (See attached "side-by-side" of tentative proposals.) Broadly, the Ball proposal tinkers with the present system by slightly raising the payroll tax rate and base, cutting benefits a little, accelerating the increase in the normal retirement age, expanding the taxation of social security benefits, and investing the trust fund in equities. (I sent you a memo on investing in equities on June 22.) The Gramlich Plan overlaps with the Ball Plan on several items, including investing in equities, but accomplishes most of its long-run deficit reduction with cuts in benefits incorporated in a major restructuring of the benefit formula and by increasing the retirement age (both the normal and the early retirement age) by more than the Ball proposal. In addition, the Gramlich Plan would allow individuals a voluntary "buy-back" of benefits in exchange for investing 1 to 4 percentage points of the payroll tax into an individual retirement account.

The attached table provides estimates of the 75-year cost saving (as a percent of payroll) for the components of the two proposals, and reflects the differences in the two approaches as of June 1995. About 30 percent of the reduction in the long-term deficit is common to both plans, i.e., higher taxation of benefits and covering new State and local workers. Neither plan includes a COLA cut. The Ball proposal closes much of the

EXECUTIVE SECRETARIAT

remaining gap by increasing the payroll tax rate and base beginning in 1998 and with the additional interest income earned on a more rapidly building trust fund. The Gramlich approach closes the remaining deficit by increasing both the early and normal retirement age by three years and lowering benefits further through a major modification of the benefit formula. His proposal produces less in additional interest earnings from investing in equities because the benefits cuts are phased in over a longer period of time than the tax increases.

Both plans are tentative and have been modified since June. For example, Ball has dropped raising the payroll tax base and both plans now phase-out the benefit taxation thresholds while keeping the other taxation of benefit changes. Ball has also added a cut in the spouse benefit and Gramlich is considering a slightly more generous benefit formula than the June version. Discussions among the members are continuing.

Broader Concerns

The two approaches, to some extent, broadly represent the difference between a traditional approach to changing social security through a combination of benefit cuts and payroll tax increases (Ball Plan), and an approach (Gramlich Plan) reflecting the view that, without payroll tax increases, significant benefit cuts will be needed to accommodate the baby boom retirement and the increases in life expectancy projected for the next century. The Gramlich approach also allows voluntary contributions into individual accounts reflecting a viewpoint that individuals should be allowed more flexibility than provided by social security in managing their retirement saving.

Both plans, however, have shortcomings:

<u>Ball Plan</u>

- The plan relies on a comparatively small short-term payroll tax increase which is unlikely to be accepted politically. Another provision would raise the payroll tax rate by an additional percentage point (on both the employer and employee) in 2060 if needed.

- It also relies on substantial savings from interest earnings based on investing a portion of the OASDI trust fund in non-government securities. Such an investment procedure is likely to be controversial. (The Gramlich plan also relies on higher investment earnings, but, as noted, to a lesser extent.)

<u>Gramlich Plan</u>

- The plan raises the early retirement age from 62 to 65 (and the normal retirement age to 68), increasing the likelihood that many low-wage workers will be forced to postpone benefit receipt despite a work-life in physically demanding occupations.

Also workers in poor health, but not sick enough to qualify for disability benefits, will be put in the same situation.

- Many supporters of the social insurance rationale for the social security program will think the Gramlich approach leads in the direction of converting the existing social insurance-based government retirement program into something more like a minimum retirement benefit program financed from general revenues. Thus, those who believe a strong social insurance program provides the best protection for basic retirement benefits for all retirees will find it difficult to support this approach.

Both Plans

- Both plans expand the taxation of social security benefits so that all benefits less individual contributions are taxed on an individual basis, raising the amount of tax paid by many beneficiaries. This will be attacked as a tax increase on the elderly. (Both plans currently contain a provision to phase out the thresholds for benefit taxation by early in the next century, raising substantially the number of beneficiaries subject to the tax.)

How Treasury Should Respond

Current estimates are that the final version of the Council's recommendations will not be released until December. A draft of the report is now scheduled to be circulated to Council members on September 25 for comment. Treasury should plan to invite the Chair and perhaps one or two other key Council members in to brief you and Larry shortly after the report is transmitted to Secretary Shalala. Such a meeting is consistent with the Secretary's role as Managing Trustee of the OASDI Trust Fund and with the Trustees' call for this Advisory Council to prepare options to return the OASDI system to long-term balance.

How the Administration Should Respond

The administration's response should be low-key. The Council's report should be taken seriously and characterized as a starting point for developing remedies to address the long-term social security financial imbalance. It may be useful and good public relations to hold a series of lower level technical meetings with the two Advisory Council Technical Panels. In addition, perhaps several technical panels of outside experts could be established to evaluate the effects of various specific recommendations, e.g., increasing the early retirement age, modifying the benefit formula substantially, and investing the trust fund partially in equities.

Attachments: Tab A: Tentative Advisory Council Proposals
Tab B: Side-by-Side Chart

TENTATIVE ADVISORY COUNCIL PROPOSALS
(As of June 1995)

Provision	Saving (Percent of Payroll over 75 Years) Ball Plan	Gramlich Plan*
Common Provisions		
Expand Coverage of State and Local Workers	0.22	0.22
Expand Taxation of Benefits	0.13	0.13
Shift Revenue from HI to OASDI Trust Fund	0.35	0.35
COLA/CPI Adjustments	--	--
Subtotal	*0.70*	*0.70*
Differing Provisions		
Payroll Tax Increases	0.56	--
Raise Retirement Age	0.10	0.98
Net Changes in Benefit Formula	0.28	0.42
Net Changes in Dependent Benefits	--	-0.19
Subtotal	*0.94*	*1.21*
Interactions	-0.03	0.10
Invest in Equities (Assumes 3.8 % real return)**	0.73	0.43
Total Saving	*2.34*	*2.44*
Projected 75- year Surplus	0.17	0.27

* Also includes voluntary "buy-back" of benefits cuts by contributing 1-4 percentage points to individual account.

** Effect on deficit depends on time pattern of proposed changes.

Side-by-Side Chart

Provision	Current Law	Ball Plan	Gramlich Plan	Kerrey/Simpson Legislation
7. Payroll Taxes	Current OASDI rate is 6.2% for employers & employees (each) and 12.4% for self-employed. HI rate is 1.45% for employers & employees (each) and 2.9% for self-employed.	Increase OASDI payroll tax 0.2 percentage points each for employer & employee (from 6.2% to 6.4% each) in 1998. "Fail-safe" increase of 1% each employer & employee in 2060, if Trust Fund out of balance.	No change from current law.	No change from current law.
8. Taxable Earnings Base	OASDI taxes are paid on earnings up to $61,200, adjusted annually to balance increases in average wages. HI taxes are paid on total covered earnings, without limitation (starting in 1994).	Increase the base by $10,000 in two $5,000 steps in 1998 & 1999.	No change from current law.	No change from current law.
9. Benefit Taxation	Up to 50% of benefits taxable with income $25,000-$34,000 (singles) and $32,000-$44,000 (couples). Up to 85% of benefits taxable with income over $34,000 (singles) and income over $44,000 (couples). Proceeds from the 50% taxation are credited to the OASDI Trust Funds and proceeds from the 51% to 85% taxation are credited to the HI Trust Fund.	Apply taxpayer's income tax rate to part of benefit that exceeds what worker paid for couples with income above $32,000 and singles above $25,000. Return <u>all</u> proceeds of this tax to OASDI Trust Funds.	Same as Ball Plan.	Redirect current tax proceeds of Social Security benefits from HI Trust Fund to OASDI Trust Funds. No increase beyond 85% in what is included in taxable income.
10. COLA/CPI	Benefits indexed to CPI-W. COLA of 2.8% paid January 1995.	No change from current law.	No change from current law.	Limit COLAs to adjustments received by Social Security beneficiaries in the 30th percentile, but allow full COLAs to those below 30th percentile. Also limit COLAs to CPI minus .5% until a proposed CPI review panel completes its work.
11. Investment Policy	A portion of Trust Funds not required to meet current costs may be invested. Investment of the funds must be made only in interest-bearing obligations of the US or guaranteed as to principal and interest by the US.	As Trust Funds increase with proposed changes, over 15 years move to invest 1/3 in equities indexed to broad market & 1/6 in corporate bonds Assumes real rate of return of 3.8%.	Same as Ball Plan.	Starting in 1998, phase-in investment so that in 15 yrs 25% of Trust Fund is in stock index fund.
12. Coverage of State & Local Workers	State/local employees not under a retirement system are covered mandatorily under Social Security and Medicare since 1990. Employees hired after March 31, 1986, are mandatorily covered under Medicare.	Cover under Social Security all newly-hired State & local workers after 1997 not now in a retirement system coordinated with Social Security.	Same as Ball Plan.	No change from current law.

Side-by-Side Chart

Provision	Current Law	Ball Plan	Gramlich Plan	Kerrey/Simpson Legislation
1. Old-Age Benefit	Current PIA--90% of first $426 of average indexed monthly earnings (AIME), plus 32% of AIME over $426 up to $2,567, plus 15% of AIME over $2,567, based the number of years after1950--or age 21, if later--up to age 62, minus "dropout years" (up to 5 years) with maximum of 35 years.	Increase the AIME computation period from 35 to 38 yrs of earnings.	(A) First deck, flatter benefit based on years of service--$499 (1995 value) for full career (35 yrs & 10 yrs min). Second deck of 15% lifetime earnings computed like current law. 40-year phase-in to new formula between 1998-2037. (B) Alternatively, "two-bracket" PIA variant: 90% of first $640, plus 15% above $640.	Beginning in 2002, add a third bend point and 10% bracket, gradually replacing over 25 yrs the 15% bracket with the 10% and the 32% bracket partially with 15%. (Like Rostenkowski)
2. Retirement Ages	NRA, for workers 62 in 2000, increases 2 mos/yr until NRA is 66 for workers 62 in 2005 & remains 66 until 2017 (the "hiatus"). NRA increases again, for workers 62 in 2017, 2 mos/yr until NRA becomes 67. Earliest Eligibility Age (EEA) remains 62 for retired workers and spouses and 60 for widow(er)s.	Eliminate "hiatus" in NRA increase.	Eliminate "hiatus" and raise NRA at rate of 1 mo/yr until age 68 in 2035. Afterwards, NRA indexed at rate of 1 mo/2 yrs. to maintain current ratio of life expectancy to NRA. Raise EEA at corresponding NRA rate to age 65/63 in 2035. EEA is not indexed thereafter.	Eliminate "hiatus" and continue increase in NRA at 2 mo/yr to 70. Starting in 2000, also increase EEA at 2 mo/yr to 65 in 2017 and link with NRA to preserve 5-yr increase in both. NRA & EEA increased after 2030 at 1 mo/2 yrs.
3. Spouse/Survivor Benefit	Spouse receives 50% of worker's PIA, subject to early retirement reductions (either spouse or worker). Widow(er) receives 100% of deceased worker's PIA subject to early retirement reductions (either widow(er) or deceased worker).	No change from current law.	Spouse receives half of $499 basic benefit if less than 10 yrs earnings. Survivor--higher of: 75% combined couples benefit, 100% survivor's own benefit, or 100% of decedent's benefit.	Beginning in 2000, gradually reduce spousal benefit at 1 percentage point/yr until maximum benefit is 33% of PIA.
4. Disability Benefit	Disability benefits are converted to retirement benefits at NRA and generally equal 100 percent of the PIA.	No change from current law.	Benefits computed using double-decker formula and not to exceed benefit payable at age 65--80% of PIA by 2035; further declines with NRA increases after 2035. Insurance requirement similar to current law.	No change from current law.
5. Individual Accounts	No current-law provision for individual accounts under Social Security.	No provision.	Optional "buy-back" cuts in benefits by contributing extra 1-4% credited to individual account recorded by SSA. [Schieber/Vargas variant: persons under 40 <u>optionally</u> could divert some fraction of payroll tax to individual accounts managed by SSA conditional on <u>extra</u> contribution & future benefit cut.]	<u>Mandatory</u> diversion of 2 percentage points of each taxpayer's OASDI payroll taxes to their own "Personal Investment Plan".
6. Earnings Inclusion			Include all earnings in numerator without increasing denominator in benefit calculation (Fierst Plan).	

The Secretary of the Treasury

August 14, 1995

NOTE TO ALICIA MUNNELL

FROM: BOB RUBIN

December 1995 could make this a difficult event to deal with.

Attachment

TREASURY CLEARANCE SHEET

NO. 95-148743
Date 8-4-95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☒ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Alicia H. Munnell, Assistant Secretary for Economic Policy
THROUGH: ______
SUBJECT: Social Security Advisory Council - Update

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John C. Hambor	JCH		Director for Office of Policy Analysis	622-8353
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

95-150028

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 15, 1995

MEMORANDUM FOR: SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Dan Sichel,
Deputy Assistant Secretary
for Economic Policy

SUBJECT: Social Security Question

In response to your question, attached is a memo providing background on the rate of return to Social Security, as discussed in the September 8 Weekly Economic Briefing (W.E.B.). Earlier today, Robert Gillingham, John Hambor, Alicia Munnell, and I met with Larry Summers to discuss the upcoming report of the Social Security Advisory Council. We expect that a draft report will be circulated on a closely held basis to members of the Council in late September, but that the report will not be completed and released to the public until December.

In anticipation of that report, we are preparing background materials on Social Security and the likely contents of the Council's report.

Attachment

Attachment

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 15, 1995

MEMORANDUM FOR DAN SICHEL

From: John C. Hambor

Subject: The Internal Rate of Return to Social Security Taxes

This memo answers the Secretary's question about the rate of return on social security.

Internal Rate of Return

- As discussed in the September 8 Weekly Economic Briefing, the rate of return to social security has declined as the system has matured. The internal rate of return referred to measures the interest rate that a worker would have to receive on lifetime social security tax payments in order to generate benefits equal to those received under social security.

- That is, if a worker made savings account deposits equal to his or her payroll tax payments and then made withdrawals from the account equal to his or her benefits, then the internal rate of return is equal to the savings account interest rate that would leave the worker with a zero balance at the end of his or her life.

  -- Thus, if the internal rate of return is larger than the interest rate available to workers for their own investments, they receive more than their money's worth from social security; that is, they receive a higher implicit return from social security than from their private savings.

  -- Conversely, if the internal rate of return is smaller than the interest rate that workers can earn privately, they do not get their money's worth from social security.

Inter-cohort comparisons

- Internal rate of return estimates by age cohort demonstrate the decline in the return on payroll tax contributions as the social security program has matured.

- For example, according to a recent study (Leimer) the return for the cohort born in 1876 (age 65 in 1941) was 36.5 percent after inflation because social security benefits were paid essentially from the beginning of the program, so that many workers paid little into the system before receiving benefits.

- As the system matured, the internal rate of return has declined steadily for subsequent cohorts as reflected in the first column in the attached Table 1. Ultimately, the projected return for cohorts born in the year 2000 and thereafter is about 1.7 percent assuming no change in current law. (This figure differs slightly from that reported in the W.E.B., reflecting slight differences in the underlying assumptions and definitions in different analyses. However, both the pattern and level of intercohort rates of return in the Leimer article are totally consistent with the Sept. 8 W.E.B.)

- The returns are even lower if action is taken to balance the long-term deficit as shown in the second column.

Intra-cohort comparisons

- In addition to comparisons across cohorts, internal rates of return are also used to compare different groups within a given cohort.

  -- For example, the progressive character of the benefit program is reflected in higher rates of return for low income workers compared to middle and maximum earners.

  -- Married couples with a single-earner have received a higher return on contributions than individuals or two-earner couples.

  -- Women tend to receive a higher return than men.

- A second recent study (Duggan, Gillingham, and Greenlees) illustrates these tendencies as shown in Table 2.

Table 1 - Inter-cohort Internal Rates of Return (%)

Birth Cohort	Present Law	Balanced System*
1876	36.5	36.5
1900	11.9	11.9
1925	4.8	4.8
1950	2.2	2.2
1975	1.9	1.8
2000	1.7	1.5
2025	1.7	1.2
2050	1.7	0.9

* This particular comparision assumes a linear increase in the payroll tax rate between 2020 and 2099.
Source: D. Leimer, " A Guide to Social Security Money's Worth Issues," ORS Working Paper #67, April 1995.

Table 2 - Intra-cohort Internal Rates of Return (%)**

Earnings:	
Low	13.8
Medium	9.9
High	7.6
Household Type:	
Individual	8.6
One-earner couple	9.8
Gender:	
Female	10.9
Male	8.5

** Based on a sample of persons born from 1895 to 1922.
Source: J.Duggan, R. Gillingham, J. Greenlees, "Returns Paid to Early Social Security Cohorts," Contemporary Policy Issues, October 1993.

TREASURY CLEARANCE SHEET

NO. ______

Date 9/15/95

MEMORANDUM FOR: ☒ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Dan Sichel

THROUGH: ______

SUBJECT: Social Security Question

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
- ☐ Enforcement
  - ☐ ATF
  - ☐ Customs
  - ☐ FLETC
  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
- ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
  - ☐ Savings Bonds
- ☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Hambor	JCH	9/15/95	Director, Policy Analysis	622-2350
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______ ☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

TREASURY CLEARANCE SHEET

NO. ______
Date 9/15/95

MEMORANDUM FOR: ☒ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Dan Sichel
THROUGH: ______
SUBJECT: Social Security Question

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
☐ Domestic Finance
☐ Economic Policy
☐ Fiscal
☐ FMS
☐ Public Debt

☐ Under Secretary for International Affairs
☐ International Affairs

☐ Enforcement
☐ ATF
☐ Customs
☐ FLETC
☐ Secret Service
☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
☐ Scheduling
☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
☐ E & P
☐ Mint
☐ Savings Bonds

☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Hambor	JCH	9/15/95	Director, Policy Analysis	622-2350
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer Date ☐ Executive Secretary Date

DO F 80-02.1 (04/89)

95-153572

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

MEMORANDUM FOR SECRETARY RUBIN

FROM: Daniel Sichel
Deputy Assistant Secretary
for Economic Policy

SUBJECT: NEC Social Security Earnings Test Meeting

Date & Time Monday, December 11, 1995, at 4:30pm

Location TBD -- at the White House

PARTICIPANTS:

Secretary Rubin
Laura Tyson
Secretary Reich
Bo Cutter
Gene Sperling
Bruce Reed
Ken Apfel
Joe Minarik
Carol Rasco
Alice Rivlin
Donna Shalala
Joe Stiglitz
Alicia Munnell
Shirley Chater
George Stephanopoulos
John Angell
Martha Foley
Mark Mazur
Ellen Seidman

BRIEFING: Overview

BACKGROUND: Tab: A - Statement of Administration Policy - H.R. 2687, Senior citizens' Right to Work Act of 1995

Earnings Test and H.R. 2684

H.R. 2684 would increase the exempt amount in the social security earnings test, in stages, from $11,280 in 1995 to $30,000 in 2002. The cost of the bill would be $7.0 billion over seven years, and it is paid for by several cuts in social security benefits. The Administration's SAP "welcomes congressional action to increase the Social Security Earnings Test". However, the Administration is on record as having misgivings about some the financing provisions in the bill. (SAP attached in Tab A.)

Current Law

- Social security beneficiaries can earn up to a certain amount of outside income before their benefits are reduced -- the so-called retirement earnings test. For beneficiaries ages 65 through 69, the earnings test reduces benefits by $1 for each $3 of earnings above the annual exempt amount, which is adjusted each year to reflect increased wage levels. The 1995 annual exempt amount for these beneficiaries is $11,280.

- Beneficiaries under age 65 lose $1 for each $2 of earnings over an exempt amount of $8,160.

- Non-wage income -- such as interest income, dividend payments, private pensions and the like -- is not counted for purposes of the retirement test. In addition, workers are exempt from the test when they reach age 70 thereby receiving full benefits regardless of earnings. The test does not apply to disability beneficiaries, who are subject instead to a substantial gainful activity test. It does apply to dependents of disability beneficiaries.

Rationale for Liberalization

Proponents of liberalizing the earnings test view the test as a penalty on work by social security beneficiaries. Thus, raising the limit would tend to increase the labor supply of the elderly, who would delay retirement or work more after receiving benefits.

However, the consensus view among most economists who have studied the issue is that changes in the earnings test will not have a sizable impact on labor supply. In the short-term, the net effect from complete repeal would be positive - but modest. In the longer-term, the effects are uncertain, as persons may adjust their lifetime labor supply in response to changes in social security rules. Liberalization would, of course, be very popular among the elderly.

Provisions of H.R. 2684

- Between 1996 and 2002, the bill would raise the earnings test exempt amount to $30,000. This would occur at a rate of $1,000 per year through 2000 and rise to $25,000 in 2001 and to $30,000 in 2002. CBO estimates the cost of increased

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

95-152998

December 5, 1995
(House)

STATEMENT OF ADMINISTRATION POLICY

(THIS STATEMENT HAS BEEN COORDINATED BY OMB WITH THE CONCERNED AGENCIES.)

H.R. 2684 - Senior Citizens' Right to Work Act of 1995
(Bunning (R) KY and 96 cosponsors)

The Administration welcomes congressional action to increase the Social Security Earnings Test. Currently, retired workers between the age of 65 and 69 who earn wages above the exempt amount have their Social Security benefit reduced by $1 for every $3 in earnings. This reduction in benefits discourages work by senior citizens who are able and willing to stay in the workforce. Raising the earnings test will increase the standard of living of the elderly and help the Nation's economy by increasing the supply of workers to the labor force. Over 900,000 Social Security beneficiaries lose some or all of their benefits as a result of the earnings test that applies at age 65.

While the Administration strongly supports increasing the Social Security earnings limit for senior citizens, its full support is contingent on accomplishing this in a deficit-neutral manner. One item of particular concern is that H.R. 2684 now achieves deficit neutrality in part by a provision that saves $3 billion in the Supplemental Security Income (SSI) program which is already assumed in balanced budget proposals put forth by both the Administration and the Congress. Using a proposal as an offset in this bill that both the Administration and the Congress have earmarked to reduce the deficit simply exacerbates the deficit reduction problem and is therefore not appropriate. The Administration recommends that the bill achieve deficit neutrality without including the savings from the SSI provision.

The Administration also has misgivings about some of the other provisions in the bill and their impact on benefit recipients. We would like to work with the Congress in these areas. For example, the Administration wants to explore options with Congress for modifying the attorneys' fees provision in ways that still meet the Administration's REGO II goals. In addition, with respect to the provisions of H.R. 2684 concerning continuing disability reviews, the Administration would not object to a mechanism that retains the oversight of the Executive Office and the appropriations committees that is inherent in the annual appropriations process. Such a mechanism could be similar to that used for the Internal Revenue Service by the 1990 Budget Enforcement Act.

H.R. 2684 would affect both direct spending and receipts; therefore, it is subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990. Office of Management and Budget scoring of this legislation is under development.

* * * * * * *

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

FAX COVER SHEET

✓ Urgent

Number of pages 2.
(excluding cover sheet)

Date 12/5

Time 5 am / pm

From: OMB Legislative Affairs
Phone: 395-4790

To: SAP DISTRIBUTION LIST

SUBJECT OF SAP: HR 2684, SENIOR CITIZENS' RIGHT TO WORK ACT

95-153198

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 11, 1995

Dan - thank you.

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM Dan Sichel DS

SUBJECT: Today's NEC Meeting on the Social Security Earnings Limit

The NEC met this afternoon to discuss the Social Security Earnings Test for beneficiaries aged 65 to 69. The House has overwhelmingly passed an increase in the earnings limit that is estimated to cost $7 billion over seven years. The Senate Finance Committee is scheduled to mark up its version of the bill tomorrow. Nothing requiring immediate attention came out of this afternoon's meeting. (For background, a copy of our summary of the House bill and the Administration's SAP are attached.)

Although the Administration is committed to an increase in the earnings limit (SAP attached), there is significant discomfort about the financing mechanism. In particular, $2 billion of the cost is paid for by welfare reform savings that are already assumed in the balanced budget proposals put forward by both the Administration and the Congress. The remainder of the cost is paid for by offsetting changes within the Social Security program.

Because the financing mechanism trades off against welfare reform, Secretary Shalala suggested that this bill be cast in the broader context of the on-going budget negotiations. (Budget rules prohibit this bill from actually being included in reconciliation, but it could be part of the broader discussion.) For the most part, there was agreement that this was a reasonable strategy.

Secretary Shalala will call Senator Moynihan prior to tomorrow's Senate Finance markup to work on strategy.

Attachments

EXECUTIVE SECRETARIAT

Earnings Test and H.R. 2684

H.R. 2684 would increase the exempt amount in the social security earnings test, in stages, from $11,280 in 1995 to $30,000 in 2002. The cost of the bill would be $7.0 billion over seven years, and it is paid for by several cuts in social security benefits. The Administration's SAP "welcomes congressional action to increase the Social Security Earnings Test". However, the Administration is on record as having misgivings about some the financing provisions in the bill. (SAP attached in Tab A.)

Current Law

- Social security beneficiaries can earn up to a certain amount of outside income before their benefits are reduced -- the so-called retirement earnings test. For beneficiaries ages 65 through 69, the earnings test reduces benefits by $1 for each $3 of earnings above the annual exempt amount, which is adjusted each year to reflect increased wage levels. The 1995 annual exempt amount for these beneficiaries is $11,280.

- Beneficiaries under age 65 lose $1 for each $2 of earnings over an exempt amount of $8,160.

- Non-wage income -- such as interest income, dividend payments, private pensions and the like -- is not counted for purposes of the retirement test. In addition, workers are exempt from the test when they reach age 70 thereby receiving full benefits regardless of earnings. The test does not apply to disability beneficiaries, who are subject instead to a substantial gainful activity test. It does apply to dependents of disability beneficiaries.

Rationale for Liberalization

Proponents of liberalizing the earnings test view the test as a penalty on work by social security beneficiaries. Thus, raising the limit would tend to increase the labor supply of the elderly, who would delay retirement or work more after receiving benefits.

However, the consensus view among most economists who have studied the issue is that changes in the earnings test will not have a sizable impact on labor supply. In the short-term, the net effect from complete repeal would be positive - but modest. In the longer-term, the effects are uncertain, as persons may adjust their lifetime labor supply in response to changes in social security rules. Liberalization would, of course, be very popular among the elderly.

Provisions of H.R. 2684

- Between 1996 and 2002, the bill would raise the earnings test exempt amount to $30,000. This would occur at a rate of $1,000 per year through 2000 and rise to $25,000 in 2001 and to $30,000 in 2002. CBO estimates the cost of increased benefit payments to $7.0 billion for the 7-year period.

- Virtually all of the cost would be paid for from four types of social security benefit cuts.

  -- The bill would increase efforts to remove recovered disability beneficiaries from the role by expanding Continuing Disability Reviews (CDR), the process of reviewing the status of individuals currently receiving benefits to establish that their medical condition still qualifies for benefits. Estimated saving - $2.6 billion.

  -- Eliminate certain stepchildren from the survivor and disability roles. Estimated saving - $1.6 billion.

  -- Delay by one year the recomputation of benefits for retired workers who, after accepting benefits, earn an amount sufficient to increase their monthly benefit payment. Estimated saving - $0.9 billion.

  -- Eliminate disability (SSDI) benefits to drug addicts and alcoholics who do not qualify for benefits based on an unrelated disability. This provision would also apply to SSI beneficiaries. Estimated saving for SSDI - $1.9 billion.

- The bill would increase the size of the Social Security Trust Fund. According to CBO estimates the combined OASDI Trust Fund would be about $300 million higher in 2000 if the bill were enacted.

Economic Policy Comments on Bill

- It should be noted that partially financing the increase in the exempt amount with delayed recomputations will reduce any positive labor market response of workers affected by both the earnings test and recomputations. Further, recomputations apply to all beneficiary age groups. For working beneficiaries age 70 and above, the earnings test does not apply so H.R. 2684 can only result in a net loss to them.

- The amounts credited to the CDR Revolving Fund are too large. The principle on which funding of this activity should be based is that the *marginal* reduction in benefits from finding ineligibles should be equal to the *marginal* cost. Since the search for ineligibles should first target those easiest to find, the marginal rule will insure that total benefit savings will far exceed the total costs of finding ineligibles. If the total value of benefit reductions were available to "seek out" additional reductions, the result would be excessive hounding of beneficiaries and the waste of the "surplus" that this activity should generate for other purposes.

95-152998

December 5, 1995
(House)

STATEMENT OF ADMINISTRATION POLICY

(THIS STATEMENT HAS BEEN COORDINATED BY OMB WITH THE CONCERNED AGENCIES.)

H.R. 2684 - Senior Citizens' Right to Work Act of 1995
(Bunning (R) KY and 96 cosponsors)

The Administration welcomes congressional action to increase the Social Security Earnings Test. Currently, retired workers between the age of 65 and 69 who earn wages above the exempt amount have their Social Security benefit reduced by $1 for every $3 in earnings. This reduction in benefits discourages work by senior citizens who are able and willing to stay in the workforce. Raising the earnings test will increase the standard of living of the elderly and help the Nation's economy by increasing the supply of workers to the labor force. Over 900,000 Social Security beneficiaries lose some or all of their benefits as a result of the earnings test that applies at age 65.

While the Administration strongly supports increasing the Social Security earnings limit for senior citizens, its full support is contingent on accomplishing this in a deficit-neutral manner. One item of particular concern is that H.R. 2684 now achieves deficit neutrality in part by a provision that saves $3 billion in the Supplemental Security Income (SSI) program which is already assumed in balanced budget proposals put forth by both the Administration and the Congress. Using a proposal as an offset in this bill that both the Administration and the Congress have earmarked to reduce the deficit simply exacerbates the deficit reduction problem and is therefore not appropriate. The Administration recommends that the bill achieve deficit neutrality without including the savings from the SSI provision.

The Administration also has misgivings about some of the other provisions in the bill and their impact on benefit recipients. We would like to work with the Congress in these areas. For example, the Administration wants to explore options with Congress for modifying the attorneys' fees provision in ways that still meet the Administration's REGO II goals. In addition, with respect to the provisions of H.R. 2684 concerning continuing disability reviews, the Administration would not object to a mechanism that retains the oversight of the Executive Office and the appropriations committees that is inherent in the annual appropriations process. Such a mechanism could be similar to that used for the Internal Revenue Service by the 1990 Budget Enforcement Act.

H.R. 2684 would affect both direct spending and receipts; therefore, it is subject to the pay-as-you-go requirement of the Omnibus Budget Reconciliation Act of 1990. Office of Management and Budget scoring of this legislation is under development.

* * * * * * *

TREASURY CLEARANCE SHEET

NO. ____
Date 12/11/95

MEMORANDUM FOR: ☒ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ____

FROM: ~~Dan Sichel~~
THROUGH: ____
SUBJECT: Today's NEC Meeting on the Social Security Earnings Limit

REVIEW OFFICES (Check when office clears)

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for International Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds

☐ Other ____

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
Daniel E. Sichel	DS	12/11/95	Economic Policy	622-0563
REVIEWERS				

SPECIAL INSTRUCTIONS

☐ Review Officer ____ Date ____ ☐ Executive Secretary ____ Date ____

96-155084

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

DEC 26 1995

MEMORANDUM FOR DEPUTY SECRETARY SUMMERS

FROM: Dan Sichel RG for
Deputy Assistant Secretary for Economic Policy

SUBJECT: Proposed Long-Range Assumptions for 1996 Social Security Trustees' Report

The Social Security actuary has proposed a set of long-range (2006-2070) economic and demographic assumptions for the 1996 OASDI and Medicare Annual Reports. The actuary's recommendations are generally the same as in last year's report, with only a marginal adjustment to the mortality and immigration projections. He is proposing no changes in the economic assumptions. Treasury must either agree with this proposal or suggest alternatives soon to allow the process of preparing the 1996 reports to proceed in a timely manner. A similar process, initiated by the actuary, will apply to short-term (10-year) assumptions once the 1997 Budget assumptions are available.

Based on the proposed long-term assumptions, the actuary estimates the OASDI 75-year actuarial deficit will increase from 2.17 percent of taxable payroll in the 1995 report to 2.28 percent in next year's report. Most of the increase is due to the addition of a negative balance year (2070) to the 75-year projections and the change in the discounting pattern due to the one year shift in projections, which together raise the deficit by 0.07 percent of payroll. The estimates may change a little once the effect on the long-term deficit of the short-term economic assumptions and possible methodological changes have been incorporated. (The attached table summarizes the effect of proposed changes on the long-term OASDI actuarial balance.)

These assumptions seem reasonable and I see no strong reason to change from last year, although I might be a little more pessimistic on real wage growth and productivity. (Note however, there maybe political sensitivity to lowering the long-run productivity assumption now.) The Advisory Council's Technical Panel on Assumptions and Methods essentially recommended no change, although about half the panel recommended slightly slower real wage growth and a higher real interest rate. Both sets of recommended intermediate economic assumptions are summarized in the table.

Ultimate Value	SSA Actuary	Advisory Council
Real Wage Growth	1.0	0.8*,1.0
Real Interest Rate	2.3	2.8*,2.3
CPI Inflation	4.0	4.0
Unemployment Rate	6.0	6.0

* Preferred by half of the technical panel.

Two complications should be noted. The actuary is proposing that any effect on the assumptions due to the shift to a chain-weighted GDP deflator and BLS adjustments to the CPI for measurement bias not be included this year because of uncertainties about the magnitude of the changes and their potential effect on the long-term actuarial deficit. (The Technical Panel recommended no change due to potential CPI changes and was silent on the chain-weighted GDP deflator.) It may be better to hold off this year if possible, and certainly, making both adjustments in the same year would be less confusing. Postponing consideration of CPI effects until next year is probably easier than postponing adjustments for a chain-weighted real GDP measure because the 1997 Budget will incorporate the new chain-weighted measure.

The second attachment provides a summary of the actuary's proposed assumptions.

RECOMMENDATION: Accept the actuary's assumptions for the 1996 report with the caveat that the effects of CPI adjustments and the chain-weighted real GDP measure on the projections will be carefully evaluated and incorporated into next year's report.

Agree __________ Disagree __________ Let's Discuss __________

Attachments

Please Log and file (may already be logged In)

[illegible]

Summary of Actuary's Proposal

Major Economic Assumptions

CPI Inflation Rate

The proposed intermediate long-range increase in the CPI is 4 percent. Although 4 percent is above recent experience, it is not noticeably above the average experience during the post-war period. The Boskin commission has stated that the current CPI may overstate inflation by as much as 1.5 percentage points. Many economists, while agreeing that the current CPI overstates inflation, believe that the Boskin Commission's figure is too high. Because of uncertainty about how much the CPI overstates inflation, how the CPI will be corrected, and what effect any corrections might have, the actuary proposes holding off on changes in the CPI assumption this year. It will be revisited for the 1997 Report.

Real Wage and Trend Productivity Growth

The intermediate long-range annual increase in real wages is 1.0 percent, unchanged from the 1995 report. Real wage growth equals an assumed trend productivity growth of 1.4 percent adjusted downward by 0.4 percent for several factors referred to as linkages (see below).

This estimated annual trend productivity growth is generally consistent with the experience over the past 30 years although it is lower than the experience since the early 1970s. However, the assumption for the ultimate increase in real earnings is higher than observed over the past three decades. The intermediate estimated growth in earnings is slightly higher than predictions by independent forecasters. The actuary is suggesting waiting until next year to incorporate the effect, if any, of the shift to a chain-weighted GDP deflator on the projection of productivity growth.

Linkages

Estimates of labor productivity growth are connected to real earnings growth through four linkages. The actuary is not recommending changing any of the linkages. The first linkage is the ratio of total worker compensation to total output, i.e. labor's share. It is assumed to be constant over the projection period. The second linkage is the ratio of earnings to total worker compensation. Since fringe benefits have increased at a more rapid rate than earnings, this ratio is falling, although the rate of decline has decreased in the past ten years with the passage of tax reform and the smaller tax advantage for fringes. The intermediate assumption proposed for the 1996 report is that the ultimate annual decline in this ratio is 0.17 percent, substantially lower than the 0.32 percent decline observed over the past 40 years. The third linkage is hours per worker;

productivity is measured per hour while earnings are calculated per year. Over the past 30 years weekly hours per worker have decreased at an annual rate of 0.36 percent, although there has been no decline in the past decade. The proposed 1996 intermediate assumption is that this decline will be 0.2 percent. The final linkage is the relative difference of GDP-measured inflation and CPI-measured inflation. Productivity growth is based on the GDP deflator while real wages are based on the CPI. The projected difference is zero for the 1996 report, although it has differed a little from zero over relatively long time periods in the past. The projected differential may change when the chain-weighted GDP deflator is incorporated into the projections.

Real Interest Rate

The intermediate assumption for the long-term real interest rate is 2.3 percent. Real interest rates have varied considerably over the past 30 years. They have increased substantially since 1981, although they have been declining recently. The average real new issue rate on trust fund assets over the past 40 years was 2.35 percent.

Unemployment Rate

The intermediate long-range age-sex adjusted unemployment rate is 6.0 percent. It has little effect on the long-run deficit.

Major Demographic Assumptions

Fertility Rate

The proposed intermediate ultimate fertility rate is 1.9 children per woman. Because of fewer than expected births in 1993-94, the fertility rates proposed in the 1996 annual report for the next 25 years are slightly lower than in the 1995 report, although the ultimate rate remains at 1.9. This adjustment has a negligible effect on the long-range actuarial balance. The fertility assumption is consistent with past experience, birth expectation surveys, and international experience.

Mortality

The actuary is proposing a faster ultimate rate of decrease in mortality for those younger than 65 for the 1996 report. No change is proposed in the rate of decrease in mortality for those 65 and older. The net effect is to increase the intermediate estimate of life expectancy in 2060 from 80.2 years in the 1995 report to 80.4 years in the 1996 report. This change raises the long-run deficit by 0.02 percent of payroll.

Immigration

No change is proposed in the expected net level of immigration, but the pattern of immigration is projected to change. The actuary is projecting an increase in illegal immigration of 50,000 per year which is exactly offset by a reduction of 50,000 in legal immigration. The 1996 intermediate estimate of ultimate annual legal immigration would be 600,000 and illegal immigration would be 300,000. Because illegal immigrants have lower wages and are less likely to participate in covered employment than legal immigrants, the projected shift in the immigration pattern increases the long-range actuarial deficit by 0.02 percent. The estimates are based on data from the Bureau of the Census and the Immigration and Naturalization Service.

TABLE B

ESTIMATE OF CHANGES IN PROJECTED
LONG-RANGE OASDI ACTUARIAL BALANCE, 1996 VS. 1995 TRUSTEES REPORTS,
ALTERNATIVE II
(As a percentage of taxable payroll)

Assumption	Long-Range Actuarial Balance Based on Alternative II
Actuarial balance shown in 1995 report 1/	-2.17
Effects of changes for 1996 report	
Valuation period 2/	-.07
Legislation	3/
Demographic assumptions	
Fertility rate	3/
Mortality rate	-0.02
Immigration	-0.02
Economic assumptions	
Real Wages	3/
Inflation (CPI)	3/
Real interest rate	3/
Unemployment rate	3/
Short-Range economic assumptions 4/	3/
Disability assumptions 4/	3/
Methods 4/	3/
Total all changes 4/	-.11
Actuarial balance for 1996 report 4/	-2.28

1/ The actuarial balances shown are based on the present value method, including the value of the trust funds on hand at the beginning of the valuation period and the cost of attaining and maintaining a 100 percent trust fund ratio.
2/ In changing from last year's valuation period of 1995-2069 to this year's valuation period of 1996-2070, the high-deficit year of 2070 is included, thus decreasing the 75-year actuarial balance of the program.
3/ Negligible, i.e., less than 0.005 percent of payroll change in actuarial balance.
4/ Preliminary

Social Security Administration
Office of the Actuary
December 5, 1995

TREASURY CLEARANCE SHEET

NO. ______

Date December 26, 1995

MEMORANDUM FOR: ☐ SECRETARY ☒ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION ☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER ______

FROM: Daniel Sichel, Deputy Assistant Secretary for Economic Policy

THROUGH: ______

SUBJECT: Proposed Long-Range Assumptinos for 1996 Social Security Trustees' Report

REVIEW OFFICES (Check when office clears)

- ☐ Under Secretary for Finance
  - ☐ Domestic Finance
  - ☐ Economic Policy
  - ☐ Fiscal
    - ☐ FMS
    - ☐ Public Debt
- ☐ Under Secretary for International Affairs
  - ☐ International Affairs
- ☐ Enforcement
  - ☐ ATF
  - ☐ Customs
  - ☐ FLETC
  - ☐ Secret Service
- ☐ General Counsel
- ☐ Inspector General
- ☐ IRS
- ☐ Legislative Affairs
- ☐ Management
- ☐ OCC
- ☐ Policy Management
  - ☐ Scheduling
- ☐ Public Affairs/Liaison
- ☐ Tax Policy
- ☐ Treasurer
  - ☐ E & P
  - ☐ Mint
  - ☐ Savings Bonds
- ☐ Other ______

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
John C. Hambor	JCA	12/26/95	Director, Policy Analysis	622-2350
REVIEWERS				
Robert Gillingham	RG	12/26	Deputy Assistant Secretary for Economic Policy	622-2220

SPECIAL INSTRUCTIONS

☐ Review Officer ______ Date ______

☐ Executive Secretary ______ Date ______

DO F 80-02.1 (04/89)

1996-SE-003711

For Alan Cohen.
RR/BL Thanks

March 29, 1996

I don't think this works, since the consolidated federal government isn't earning any more. All that's happening is that money is being shifted from other parts of budget to social security to meet the increased performance of the equity piece, if that occurs.

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Alan Cohen AC
Senior Advisor to the Secretary

SUBJECT: An Alternative to Investing the Social Security Trust Fund in Equities

DISCUSSION: The proposal to allow investment of a portion of Social Security Trust Fund balances in equities could create many problems. However, the proposal has significant support in some circles because it provides a way of augmenting the size of the Trust Fund balances, thereby limiting the need for benefit cuts and tax increases. This support could lead to enactment of the proposal, even though significant problems might result.

I have an alternative that would achieve the same augmentation of the Trust Fund balances **without any of the problems that would result from actually investing equities outside the Federal Government.** In considering this idea, please compare it to the original proposal, not just to current law.

Background

It is my understanding that we currently issue special non-marketable Treasury securities to many Trust Funds, including Social Security. These "specials" can have somewhat different characteristics than those of securities which are issued to the public. For example, the "specials" may differ from other Treasury securities in ways that affect liquidity. Many of the Trust Funds can get "specials" with yields equal to long-term interest rates **without sacrificing any liquidity, because they are allowed to redeem these "specials" at par at any time.** Thus, for purposes of issuing securities to Trust Funds, there is a precedent for creating instruments that are not identical to those available to the public.

The Alternative Proposal

My alternative proposal is to permit Trust Funds -- but not the public -- to invest a portion of assets in a **new type of** non-marketable Treasury "specials." The value of these investments securities could be ~~tied~~ to a broad-based equity index or to an index tied to GDP growth. The Trust Funds could redeem these specials in the future in the same way that specials can be redeemed under current procedures.

Under this alternative, no cash would leave the Federal

government. Treasury borrowing would continue exactly as it does now. Moreover, from a budget perspective, the purchase of these new specials by Trust Funds would be an intragovernmental transaction and there would not be any effect on the deficit.

These specials would not be available to the public. Nor should they be. Markets already provide indices in which the public can invest.

Under my proposal, the managers of each Trust Fund would have the option of switching a portion of their assets into these new specials. They could switch some or all of the assets back at any time. But none of the money would leave the Federal Treasury.

The major impact of this change would be to provide an option for Trust Funds to augment their balances over the long-term -- assuming equity or GDP indices outperform Treasury notes and bonds over the long haul. Therefore, some Trust Funds could exhaust their balances at a later date than under current law. All other things being equal, this could increase Federal spending.

This impact would, of course, be attractive to the constituencies served by these Trust Funds. This effect might, however, alarm deficit hawks who feel that entitlements need to be curbed -- especially in the face of the retirement of the huge baby boom cohort beginning in 2010. However, the deficit hawks need not really be alarmed about creating these "specials." The real economic pressure for entitlement reductions comes from the effect of program taxes and expenditures on annual deficits, not from the impact of Trust Fund balances. This is a point that the Concord Coalition, among others, has been making for quite some time now.

For example, soon after 2010, Social Security will spend more than it collects in payroll taxes each year. This will add to annual deficits, whereas now, Social Security is running surpluses that reduce annual deficits. Similarly, as was anticipated quite some time ago, Medicare Part A is in annual deficit about now, and this will add to annual budget deficits in future years. And of course, Medicare Part B effectively has no Trust Fund at all but adds to annual deficits each year. These strong pressures on the deficit would remain just as strong, even if the alternative proposal is adopted. The deficit pressures would in turn generate strong pressures for spending cuts and payroll tax increases in each of these programs.

It may be argued by some that the Government would be hurting itself by taking cash from Trust Funds and requiring itself to pay back more cash in redemptions than it could earn by investing the money at Treasury bond yields. But the real ability of the Federal Government to redeem these trust fund investments with cash in the future is determined by the growth in its revenue base. Growth in the revenue base is closely correlated with the growth in GDP. Growth in the revenue base is not linked to growth of assets that are earning money at Treasury's long-term interest rates. To the extent that stock prices over the very long-term track growth in the economy, broad-based equity indices may also be an appropriate investment option upon which to base the new specials.

Note also that the Federal Government does not now engage in long-term investing outside of the Treasury in order to be able to pay back Trust Funds at a later date. However, if hypothetically it did, it might want to find a higher return than the yield on long-term Treasury bonds. This would be especially true in view of the ability of the Government to absorb risk, given its size, and the absence of urgent liquidity requirements given the long-term nature of such hypothetical investments. These, of course, are the same issues which are driving some Social Security analysts to advocate permitting broad-based equity index fund rates of return for Social Security's assets.

Summary

This alternative achieves the objective of the advocates of the current proposal but has none of the implementation drawbacks. The proposal may appear to reduce the pressure for entitlement changes, but from an economic point of view, that pressure would still be just as strong. It might also appear to force the Treasury to redeem excessive amounts of money in future years, but on closer inspection, such sums may not really be excessive.

That is the problem

The Secretary of the Treasury

April 1, 1996

NOTE FOR ALAN COHEN

FROM: BOB RUBIN

I don't think this works, since the consolidated federal government isn't earning any more. All that's happening is that money is being shifted from other parts of budget to social security to meet the increased performance of the equity piece, if that occurs.

Attachment

NCC faxed to RER 3/29/96
NCC to LS
NCC " to JBN SMAT
4/1/96 SO

Please LOG IN

1996-SE-002741

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

APR 18 1996

ASSISTANT SECRETARY

MEMORANDUM FOR SECRETARY RUBIN
DEPUTY SECRETARY SUMMERS

FROM: Joshua Gotbaum
Les Samuels

SUBJECT: Proposal to Restructure Social Security Contributions

SUMMARY

President Clinton requested comments on a proposal by Robert S. McElvaine, a professor of Arts and Letters at Millsaps College in Jackson, Mississippi, to eliminate the ceiling on wages subject to OASDI taxes ($62,700 in 1996) and to lower the OASDI tax rate in a revenue-neutral way. McElvaine asserts that eliminating the ceiling would permit the total OASDI and HI tax rate (15.3 percent, of which 12.4 percent is OASDI and 2.9 percent is HI) to be reduced to 10 percent or less and would provide tax benefits for small business, increase consumer demand, and promote job creation.

We disagree. We believe McElvaine's analysis is inaccurate and that the proposal is unwise.

The proposal would raise marginal tax rates on workers above the cap to very high levels (an increase of 13.18 percentage points), but not reduce them very much for workers below the cap (a decrease of 2.12 percentage points). There is also a substantial risk of strong political response, as well as the possibility that some workers with high levels of earned income would be able to convert this income to income not subject to social security taxation.

McElvaine, by focusing solely on payroll taxes and not on the related benefits, concludes that the OASDI program is highly regressive. When OASDI benefits are considered, exactly the opposite is true. McElvaine's approach would make it even more so, but we think the costs heavily outweigh the benefits.

You may wish to share this analysis with Leon Panetta.

DISCUSSION

OASDI PAYROLL TAX RATES WOULDN'T DECLINE MUCH

McElvaine believes that uncapping the OASDI wage base would permit a reduction in the combined OASDI and HI tax rate from 15.3 percent to 10 percent (5 percent each for employers and employees). In fact, the reduction would be far smaller. If total OASDI revenues are to remain unchanged (and assuming no behavioral responses to the tax changes), the OASDI tax rate would decline by only 2.12 percentage points, reducing the total tax rate from 15.3 percent to 13.18 percent (6.59 percent each for employers and employees).[1]

Most economists agree that payroll taxes, whether imposed on employers or employees, are generally borne by workers through reductions in wages or other compensation. Our estimate is based on that assumption. Had we not assumed that changes in the employer share of OASDI would be passed on to employees in the form of changes in their money wages, the estimated revenue-neutral decline in the OASDI rate would have been smaller.

INCOME TAX RECEIPTS MAY BE REDUCED

As the result of employees bearing the burden of the employer share of OASDI taxes, McElvaine's proposed revenue neutral change in OASDI would likely result in lower money wages for high-wage workers and higher money wages for low-wage workers. Because marginal income tax rates are higher for higher income workers, the consequence would be a decline in income tax receipts of, very roughly, $3 billion per year. If the OASDI tax rate were set to exactly offset this income tax revenue loss, the OASDI rate decline would have to be even smaller than 2.12 percentage points. In that event, OASDI revenue would increase by the same amount that income tax revenue decreased.

Higher Marginal Tax Rates and Behavioral Response. Under the McElvaine proposal, earnings above the OASDI ceiling of $62,700 would be subject to an OASDI tax rate of 10.28 percent -- and a total payroll tax rate of 13.18 percent when the 2.9 percent HI tax is included. This would be in addition to a marginal Federal income tax rate of between 28.0 and 40.8 percent (that is, 39.6% and the impact of the limitation on itemized deductions) plus any applicable marginal state income tax rates. Even without state taxes, the combined Social Security and Federal income taxes would result in a marginal tax rate on earnings of higher-wage workers of between 41.2 percent and 54.0 percent.[2]

Higher income workers would also have an incentive to convert wage income to nonwage income if their marginal earnings were subject to an additional 13.18

---

[1]Social Security taxes (FICA) consist of three separate components: (1) Old-Age and Survivors (OASI); (2) Disability Insurance (DI); and (3) Hospital Insurance (HI). Employers and employees each pay 5.26 percent for OASI, 0.94 percent for DI, and 1.45 percent for HI. There is no cap on wages for the HI tax. For the OASI and DI components, only wages up to an indexed maximum ($62,700 in 1996) are taxed.

[2]Such high tax rates might adversely affect the incentives of high-income workers to generate additional labor income. If such behavioral effects had been included in the estimate, the decline in the payroll tax rate would have been even smaller.

percent tax. Many, especially the self-employed, would have the ability to do so.[3] For example, if only 10 percent of the newly-covered earnings were converted, the revenue-neutral OASDI tax rate would increase by 0.15 percentage points. More importantly, HI tax receipts would decline by about $1.4 billion per year, resulting in a net decline in total receipts of about $1.1 billion.

Changes in OASDI Tax Rates and the Economy. A revenue-neutral change in OASDI contributions could stimulate economic activity only if there is a much stronger behavioral response from low-wage than high-wage individuals. In fact, the opposite is far more likely to occur, since the marginal tax rate of higher income workers would increase by 13.18 percentage points while the tax rate for lower income workers would fall by only 2.12 percentage points. The negative incentives for high-income workers would almost certainly outweigh the positive incentives for low-income workers.

BENEFITS AREN'T CONSIDERED

The McElvaine proposal ignores the benefit side of the OASDI program. Workers above the cap would experience a significant increase in taxes (a marginal tax rate increase of 13.18 percentage points on work) but would not receive additional OASDI benefits unless the wage cap were also raised in the computation of benefits. In the latter case, however, the proposal would not be budget neutral as future benefit liabilities would be created. Thus, the proposal can be viewed as a purely redistributive one -- from high-wage workers to low-wage workers. If redistribution of the tax burden is the goal, however, higher tax rates on all income (rather than just wage income) of higher income taxpayers may be a better way of accomplishing that goal.

McElvaine's focus on revenues leads him to characterize the OASDI tax rate as extraordinarily regressive. When benefits are considered, however, the opposite conclusion emerges. Because the OASDI benefit formula is very progressive, net benefits (benefits minus contributions) are higher relative to earnings for low-wage than for high-wage workers. The degree of progressivity is elevated by the taxation of OASDI benefits for high-income beneficiaries.

[3] About 10 percent of covered workers are self-employed. About 6.5 percent of self-employed workers, with about 28 percent of self-employment income, are above the cap.

1996-SE-003199

log / file

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

MEMORANDUM FOR THE PRESIDENT

THROUGH: Robert E. Rubin REP

FROM: Joshua Gotbaum JG
Assistant Secretary for Economic Policy
Les Samuels LS
Assistant Secretary for Tax Policy

SUBJECT: **Proposal to Restructure Social Security Contributions**

You requested comments on a proposal by Robert S. McElvaine, a professor of Arts and Letters at Millsaps College in Jackson, Mississippi, to eliminate the ceiling on wages subject to OASDI taxes ($62,700 in 1996) and to lower the OASDI tax rate in a revenue-neutral way. This memorandum summarizes our reaction; attached is more detailed discussion.

McElvaine asserts that eliminating the ceiling would permit the total OASDI and HI tax rate (15.3 percent, of which 12.4 percent is OASDI and 2.9 percent is HI) to be reduced to 10 percent or less and would provide tax benefits for small business, increase consumer demand, and promote job creation.

We disagree. We believe McElvaine's analysis is inaccurate and that the proposal is unwise.

The proposal would raise marginal tax rates on workers above the cap to very high levels (an increase of 13.18 percentage points), but not reduce them very much for workers below the cap (a decrease of 2.12 percentage points). There is also a substantial risk of strong political response, as well as the possibility that some workers with high levels of earned income would be able to convert this income to income not subject to social security taxation.

McElvaine, by focusing solely on payroll taxes and not on the related benefits, concludes that the OASDI program is highly regressive. When OASDI benefits are considered, exactly the opposite is true. McElvaine's approach would make it even more so, but we think the costs heavily outweigh the benefits.

Attachment

Comments on a Proposal by Robert S. McElvaine to Restructure Social Security Contributions

OASDI Payroll Tax Rates Wouldn't Decline Much

McElvaine believes that uncapping the OASDI wage base would permit a reduction in the combined OASDI and HI tax rate from 15.3 percent to 10 percent (5 percent each for employers and employees). In fact, the reduction would be far smaller. If total OASDI revenues are to remain unchanged (and assuming no behavioral responses to the tax changes), the OASDI tax rate would decline by only 2.12 percentage points, reducing the total tax rate from 15.3 percent to 13.18 percent (6.59 percent each for employers and employees).[1]

Most economists agree that payroll taxes, whether imposed on employers or employees, are generally borne by workers through reductions in wages or other compensation. Our estimate is based on that assumption. Had we not assumed that changes in the employer share of OASDI would be passed on to employees in the form of changes in their money wages, the estimated revenue-neutral decline in the OASDI rate would have been smaller.

Income Tax Receipts May Be Reduced

As the result of employees bearing the burden of the employer share of OASDI taxes, McElvaine's proposed revenue neutral change in OASDI would likely result in lower money wages for high-wage workers and higher money wages for low-wage workers. Because marginal income tax rates are higher for higher income workers, the consequence would be a decline in income tax receipts of, very roughly, $3 billion per year. If the OASDI tax rate were set to exactly offset this income tax revenue loss, the OASDI rate decline would have to be even smaller than 2.12 percentage points. In that event, OASDI revenue would increase by the same amount that income tax revenue decreased.

Higher Marginal Tax Rates and Behavioral Response. Under the McElvaine proposal, earnings above the OASDI ceiling of $62,700 would be subject to an OASDI tax rate of 10.28 percent -- and a total payroll tax rate of 13.18 percent when the 2.9 percent HI tax is included. This would be in addition to a marginal Federal income tax rate of between 28.0 and 40.8 percent (that is, 39.6% and the impact of the limitation on itemized deductions) plus any applicable marginal state income tax rates. Even without state taxes, the combined Social Security and

---

[1]Social Security taxes (FICA) consist of three separate components: (1) Old-Age and Survivors (OASI); (2) Disability Insurance (DI); and (3) Hospital Insurance (HI). Employers and employees each pay 5.26 percent for OASI, 0.94 percent for DI, and 1.45 percent for HI. There is no cap on wages for the HI tax. For the OASI and DI components, only wages up to an indexed maximum ($62,700 in 1996) are taxed.

Offices of Economic and Tax Policy
Department of the Treasury

Federal income taxes would result in a marginal tax rate on earnings of higher-wage workers of between 41.2 percent and 54.0 percent.[2]

Higher income workers would also have an incentive to convert wage income to nonwage income if their marginal earnings were subject to an additional 13.18 percent tax. Many, especially the self-employed, would have the ability to do so.[3] For example, if only 10 percent of the newly-covered earnings were converted, the revenue-neutral OASDI tax rate would increase by 0.15 percentage points. More importantly, HI tax receipts would decline by about $1.4 billion per year, resulting in a net decline in total receipts of about $1.1 billion.

Changes in OASDI Tax Rates and the Economy. A revenue-neutral change in OASDI contributions could stimulate economic activity only if there is a much stronger behavioral response from low-wage than high-wage individuals. In fact, the opposite is far more likely to occur, since the marginal tax rate of higher income workers would increase by 13.18 percentage points while the tax rate for lower income workers would fall by only 2.12 percentage points. The negative incentives for high-income workers would almost certainly outweigh the positive incentives for low-income workers.

BENEFITS AREN'T CONSIDERED

The McElvaine proposal ignores the benefit side of the OASDI program. Workers above the cap would experience a significant increase in taxes (a marginal tax rate increase of 13.18 percentage points on work) but would not receive additional OASDI benefits unless the wage cap were also raised in the computation of benefits. In the latter case, however, the proposal would not be budget neutral as future benefit liabilities would be created. Thus, the proposal can be viewed as a purely redistributive one -- from high-wage workers to low-wage workers. If redistribution of the tax burden is the goal, however, higher tax rates on all income (rather than just wage income) of higher income taxpayers may be a better way of accomplishing that goal.

McElvaine's focus on revenues leads him to characterize the OASDI tax rate as extraordinarily regressive. When benefits are considered, however, the opposite conclusion emerges. Because the OASDI benefit formula is very progressive, net benefits (benefits minus contributions) are higher relative to earnings for low-wage than for high-wage workers. The degree of progressivity is elevated by the taxation of OASDI benefits for high-income beneficiaries.

---

[2]Such high tax rates might adversely affect the incentives of high-income workers to generate additional labor income. If such behavioral effects had been included in the estimate; the decline in the payroll tax rate would have been even smaller.

[3]About 10 percent of covered workers are self-employed. About 6.5 percent of self-employed workers, with about 28 percent of self-employment income, are above the cap.

Offices of Economic and Tax Policy
Department of the Treasury

CHIEF OF STAFF TO THE PRESIDENT

To [illegible] [illegible].

[illegible]

[illegible]

(1)

THE PRESIDENT HAS SEEN
11-15-95

Oct 19, 1995

Dear Cherry,

I am asking you, if at all possible, to get this directly to President Clinton, and to somehow ensure that he himself reads it. It is cogent idea about Social Security and taxation that could prove a real political coup for the President. It is from Prof. Robert McElvaine, my author of "The Great Depression"

What the Democrats need to get out of their Chapter Eleven of the mind is a "Big Idea" that sharply delineates the difference between their basic outlook and that of the Republicans.

Here's a good candidate for that Big Idea: Remove the cap on income susceptible to Social Security taxes (currently $61,200) and lower the rate of that payroll tax. As it stands now, a near-minimum wage worker making $10,000 annually pays 7.5% of his/her wages in FICA-Medicare taxes, while a CEO who carries off $5 million pays only 1.52% of his income for the same purpose.

Americans pay two principal taxes to the federal government. One is mildly progressive, the other extraordinarily regressive.

Leon Leon Erskine

What do you think of this? What do you think of this?

BC BC

THE PRESIDENT HAS SEEN

(2)

The Republicans propose to flatten the progressive one, thereby helping the rich, but to leave the very regressive one untouched, thus doing nothing for the middle class or the poor. Democrats have a golden opportunity to take the opposite position: keep the income tax progressive and flatten the regressive FICA tax.

Republicans have indicated a willingness to means test Medicare benefits. The FICA tax is currently based on a *negative means test*: the less one earns, the larger the share of his or her income that is taken by this tax.

Why not apply means tests to taxes? That is all that progressive taxation is. Of course lifting the cap on income susceptible to the FICA tax would *not* means test it; it would merely remove the negative means test on which it is now based. It would not make this tax progressive; it would produce a *flat tax*. That's what most Republicans claim they want, so how could they argue against a flat tax to support Social Security and Medicare?

Nearly half of all income now goes to the top 20% of income recipients, which is approximately the same as the group that earns above the current FICA cap. This suggests that a conservative estimate is that applying the FICA tax to all income would allow the rate to be reduced at least to the 5% range. The effects of such a change would be dramatic. The FICA-Med tax paid by a person earning $35,000 a year would be reduced by $1000 annually, adding more than $80 to his or her monthly take-home pay. The wage-earner making the current cap of $61,200 now pays $4590; at 5% that would drop to $3060, adding more than $125 a month to his/her take-home

(5)

pay. What's more, this would not be money people had to wait to receive in tax refunds; they would see it directly added to every paycheck. And, although persons earning above the current cap would pay tax on all their income, their total FICA-Med tax would remain below what they now pay until they passed $104,000 in annual income.

This proposal would stimulate the economy by giving consumers more money, combat the fundamental problem of growing maldistribution of income, and be a great boon to small businesses (which rarely pay any employee above the current cap and so would see their share of the payroll tax substantially reduced). It would spur job creation and reduce unemployment, since the size of the payroll tax is one of the greatest obstacles to hiring new workers. It would also be something of a disincentive to the payment of the huge salaries that many Americans find so disturbing. Perhaps Jerry Jones would pay Dieon Sanders a little less if he had to pay the employer's share of the FICA tax on *all* of it.

This is, moreover, a way to assure the solvency of Social Security and Medicare, since by significantly reducing the tax rate now, there would be room for modest increases as needed in the future to cover the huge number of retirees in the Baby Boom generation. This, in turn, would restore confidence in the system. Younger people would have a strong assurance that Social Security and Medicare will be there for them when they retire.

The only people who would pay significantly more are those

(4)

making above about $200,000 a year—precisely those whose incomes have been skyrocketing in recent years while all others have been left in the dust.

This could be the key to reuniting Democrats and winning back the allegiance of a unified middle and lower class. It could be a major step towards securing the reelection of President Clinton and restoring Democratic majorities in Congress.

How could the GOP argue against it? Surely they would scream "class warfare," their standard response to any proposal for fairness and equity. In fact the regressive FICA tax that presently exists is part of the class warfare on the middle class and working poor that has been waged for many years and is being increased almost daily by the Republican majority in Congress. The FICA flat tax would merely be a defensive maneuver in the class war in which Republicans and the wealthy are very much on the offensive.

There is only one argument against this: that Social Security is a retirement fund, and no one should have to pay vastly more in taxes than she or he will receive back in benefits. But this argument has already been undermined by the lifting of the cap on the Medicare tax, by the fact that almost all participants now receive far more than they put into the system, and by the fact that the system is actually run on a pay-as-you-go basis.

This idea would correct one of the basic mistakes in the original Social Security Act. The potential benefits far outweigh the solitary objection that this is a pension system and obliging the rich to pay much more than they will get out of it is unfair to them.

I have discussed this proposal with several leading Democrats in the Congress and with White House advisers in recent weeks. The reception has been unanimously favorable, ranging from a high-ranking adviser to the President who said, "That's a *really big* idea; we need to look at it carefully," to Sen. Dale Bumpers' response: "That's a *dynamite* idea!"

This proposal has everything to recommend it. Economically, it would put significantly more money in the hands of middle-class and poorer consumers, thereby providing stimulus to the economy, and it would materially assist small businesses. Morally, it would be a step to begin to counter the rapid skewing of income to the few at the expense of the many. Politically, it would bring together the middle class and the poor, allowing the Democrats to make an effective and honest case that they are looking out for the well-being of the vast majority of Americans, while the Republicans are presenting proposals designed to assist only the rich.

Removing the cap on income susceptible to the FICA tax and lowering the rate of that tax is the right thing to do in terms of economics, morality, and politics.

What are the Democrats waiting for?

(Robert S. McElvaine is Elizabeth Chisholm Professor of Arts and Letters and Professor of History at Millsaps College in Jackson, Mississippi. He is working on a manuscript, What's Left?, which seeks to define a new

1996-SE-003351

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

April 30, 1996

to: Linda R.
Bob Bean
from: Bob Rubin

INFORMATION

MEMORANDUM FOR SECRETARY RUBIN

FROM: Linda L. Robertson LR
Assistant Secretary
(Legislative Affairs & Public Liaison)

Robert Bean
Senior Legislative Specialist

SUBJECT: IRS Funding

No question in my view, we will need to defend this in public domain

In a speech last week, Speaker Gingrich listed as a Republican priority "shifting one-third of IRS personnel to drug enforcement and border patrol," according to the attached news article which contains a second-hand attribution referencing a nationally syndicated column. The Speaker's statement suggests that the Congressional leadership may potentially seek to use the subject as a high-profile legislative issue at some point in the coming weeks and months. In any case, funding for the IRS will arouse considerable attention in the FY 97 appropriations cycle, and the subject is certain to attract Congressional challenges as a lightning rod for anti-government, anti-tax initiatives.

In view of this, we recommend your involvement in a series of strategy meetings to develop our legislative and political strategy for IRS funding issues. We will follow up shortly with a more detailed proposed set of meetings and possible strategies.

Attachment

cc: Deputy Secretary Summers
Commissioner Richardson
Sylvia Mathews
Ben Nye
Michael Barr
David Dreyer
Erik North
Floyd Williams
Alan Cohen

NCC to LS 4/30/96 ~~4/30/96~~
NCC to DDH 5/1/96
("reading")
NCC to JBN
SMAT
SD

Please
Log IN

EXECUTIVE SECRETARIAT

The Secretary of the Treasury

May 6, 1996

NOTE TO LINDA ROBERTSON
BOB BEAN

FROM: Bob Rubin

No question in my view, we will need to defend this in public domain.

1996-SE-011547

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

CLOSE HOLD

ASSISTANT SECRETARY

December 9, 1996

To: **Bob Rubin**

From: Josh Gotbaum

Re: ***The* Social Security Commissioner**

Given all the visibility that Social Security will have in the next few years, the next Commissioner is an important personnel choice. For the reasons described below, I would favor an energetic politician with a flair for the bully pulpit far more than a "policy wonk".

There are at least three separate aspects of the job:

1. Policymaking
2. Management, and
3. Marketing & communications.

Some will disagree, but I believe the latter is the one that matters most for this position.

As the Greenspan commission showed, Social Security policymaking cannot be done except by very senior Administration officials; even though head of a separate department, the Commissioner is unlikely to meet this test. Other Administration officials (e.g., you and the other NEC principals) are much better placed.[1]

As to management, the Social Security Administration is recognized as one of the better-managed operations in government: Its computers work and SSA answers the phone. We should save our managerial talent for the FAA and the IRS.

The real shortcomings are largely in marketing and communications of the program. When benefits were raised to reflect the cost-of-living adjustment, SSA simply sent out a press release. (Is there any other program in government that would expand by $10 billion and not even hold a press conference?) Outside polls really *do* report that a majority of Generation X-ers believe they will never receive Social Security benefits. This weakness will become increasingly critical as the drumbeat to change the program

[1] Senator Moynihan supported the creation of a separate department and the enhancement of its status in part to ensure that the Social Security Commissioner (who is subject to Senate confirmation and oversight), *would* be at the table. There is historical precedent here, but one needs to go back to Bob Ball, who was Commissioner for a long period in the 1960's and who remains one of the most active advocates for the program. Most commissioners since have been functionaries.

grows. Without a competent, energetic communications effort, that debate could be derailed by the most simplistic and demagogic of charges – Harry & Louise will look scholarly by comparison.

For these reasons, it makes more sense to appoint an outgoing, energetic politician with an eye to higher office than a Social Security policy wonk. A strong mayor (e.g., Mayor Campbell) or Lieutenant Governor could see the benefits of the position, and could help the program at the same time he or she would help themselves.

1996-SE-011675

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

Larry —
I assume Chile government does not guarantee performance

December 10, 1996

MEMORANDUM TO THE PRESIDENT

THROUGH: Robert Rubin

FROM: Lawrence Summers

You sent Secretary Rubin a copy of <u>The Economist</u> article on the Chilean Social Security system. We had looked closely at the Chilean system which provides a public minimum benefit and mandates that individuals contribute to their own accounts.

Chile's Social Security system, introduced in the early 1980's, has been an important part of their successful economic strategy. The savings rate has soared and the financial market has matured in Chile, spurring growth rates in the 8 percent range. And Chile's retirement population is much more economically secure than it was a decade ago.

However, there are important differences between the Chilean and American situations:

(i) Retirees in Chile have benefitted from a 20-fold stock market appreciation over the last 15 years, something that is not available here going forward.

(ii) Chile corrected many other problems such as huge trade barriers in its economy during the 1980's. It also cut government spending very substantially.

(iii) Chile's pre-existing commitment to retirees before its new system was much smaller than ours, making transition easier.

The Secretary of the Treasury

December 11, 1996

NOTE FOR LARRY SUMMERS

FROM: BOB RUBIN

Larry -

I assume Chile government does not guarantee performance?

Attachment

The Secretary of the Treasury

December 11, 1996

NOTE FOR LARRY SUMMERS

FROM: BOB RUBIN

Larry -

I assume Chile government does not guarantee performance?

Correct
Larry

Attachment