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STAFF DATA WITH RESPECT TO H.R. 17550

SOCIAL SECURITY AMENDMENTS OF 1970

PREPARED BY THE STAFF

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE
RUSSELL B. LONG, *Chairman*

PART 2

AUTOMATIC ADJUSTMENTS IN SOCIAL SECURITY BENEFITS AND TAXABLE WAGE BASE

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AUTOMATIC ADJUSTMENTS IN SOCIAL SECURITY BENEFITS AND TAXABLE WAGE BASE

I. INTRODUCTION

H.R. 17550, as passed by the House of Representatives, contains provisions which would automatically increase social security benefits as the cost of living rises, the social security tax base as earnings covered under the program rise, and the earnings limitation ("retirement test") as covered earnings rise. The staff has collected data relating to these provisions and has compared these data with the results in the past of congressional action to increase social security benefits.

There is a paucity of data on the effects of the proposals in the future, but the data on what the effect would have been had the proposals been in effect in the past shows that in the long run, absent other legislation, social security beneficiaries would have fared less well under the automatic provisions than they did under the benefit revisions which took place after the enactment of the Social Security Amendments of 1939. On the other hand, the increases in benefits have been less frequent than they would have been had the automatic cost-of-living provisions been in effect.

The Department has made no actuarial study of the automatic provisions which are part of the administration's legislation program. The cost-of-living benefit proposal was advanced on the theory that it could be financed by an automatic increase in the amount of wages taxed (the "taxable wage base"); this necessitated an assumption that over the long-range future the cost of living would rise at about one-half the rate that average earnings covered by the program would rise.

Lacking actuarial studies which could be used to evaluate the effect of the automatic provisions, the staff requested certain data on the basis of tax base projections prepared by the Social Security Administration in connection with the cost of the hospital insurance program. These tax-base projections were prepared to show the tax bases which would be needed to finance the hospital insurance program under the tax schedule contained in the House-passed bill. Also, the staff is unaware of any studies of the possible fiscal effect—either on the private or the Government sectors of the economy—of the automatic proposals.

This committee print contains the substance of the data collected by the staff and is divided into several parts. One part mentions the major arguments for and against the provision, another describes the provision of the House-passed bill, a third section describes the automatic cost-of-living provisions of other Federal programs, while the remainder of the print is devoted to selected representative data on the House-passed provisions.

II. ARGUMENTS ADVANCED FOR AND AGAINST PROVISIONS IN THE HOUSE BILL

A. Automatic Benefit Increases

The Following Arguments Have Been Advanced in Favor of the Proposal:

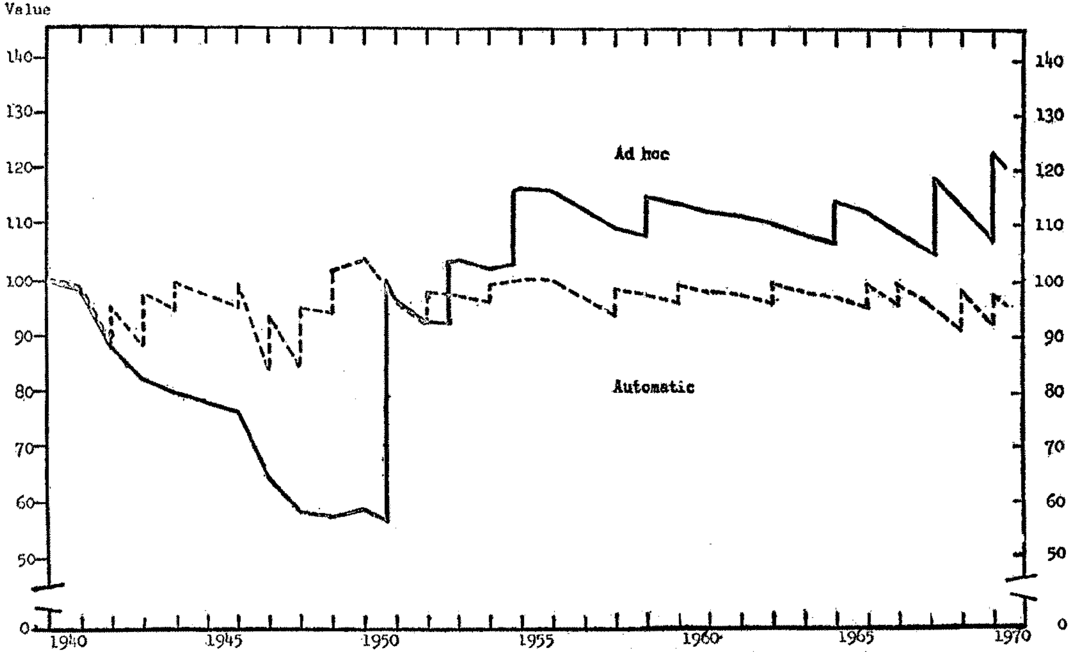
1. People living on fixed incomes, such as social security benefits, suffer the most from inflation and rises in the cost of living. Therefore, social security benefits should be increased as the cost of living goes up.
2. Although Congress has expressed an intention to adjust social security benefits as the cost of living goes up, increases in social security benefits have been slower in coming than the rise in the cost of living. An automatic provision would assure benefit increases relatively soon after any significant increases in living costs. For example, from 1955 to 1970, four benefit increases went into effect: one in 1959, one in 1965, another in 1968, and the most recent in 1970. Had the cost-of-living provisions gone into effect after 1954, benefits would have been increased seven times, first in 1958, again in 1960, 1963, 1966, 1967, 1969, and 1970. As a result, benefits would have been increased at about the same rate as the cost of living went up and social security beneficiaries would have been spared the interim consequences of having to make do on a fixed income while living costs were going up. Thus, the automatic cost-of-living provision can be expected to provide more frequent increases than would occur under periodic congressional review.
3. Automatic cost-of-living increases will take social security out of the political arena by eliminating the need for periodic action by Congress to raise benefits. In this way Congress would be relieved of the need to expend vast amounts of scarce time and energy considering the need for social security benefit increases and could devote its resources to considering other revisions in the program.
4. It is expected that automatic cost-of-living increases in benefits can be had without increasing social security tax rates, provided that the tax base is increased to take account of rising wage levels.

The Following Arguments Have Been Raised Against the Proposal:

1. The increases in social security benefits voted by Congress since 1940 have more than kept up with the rises in the cost of living. (See charts I, II, and III and table I.) From 1940 to January 1970, the Congress has increased social security benefits by 251.5 percent while the cost of living had gone up only 171.8 percent.

Chart I

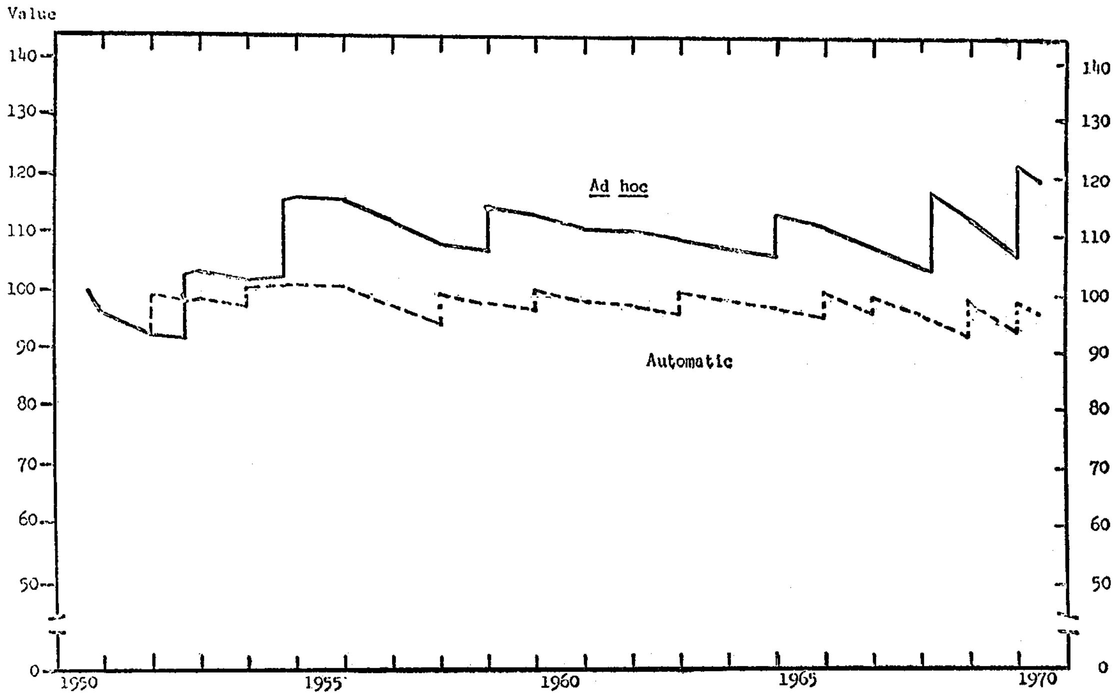
Value of Benefits Since 1940
Under the Increases Enacted Since 1940
And under an Assumed Automatic Adjustment System 1/



1/ It is assumed that the Administration's proposal for automatic adjustment of benefits to increases in prices was in effect since 1940

Chart II

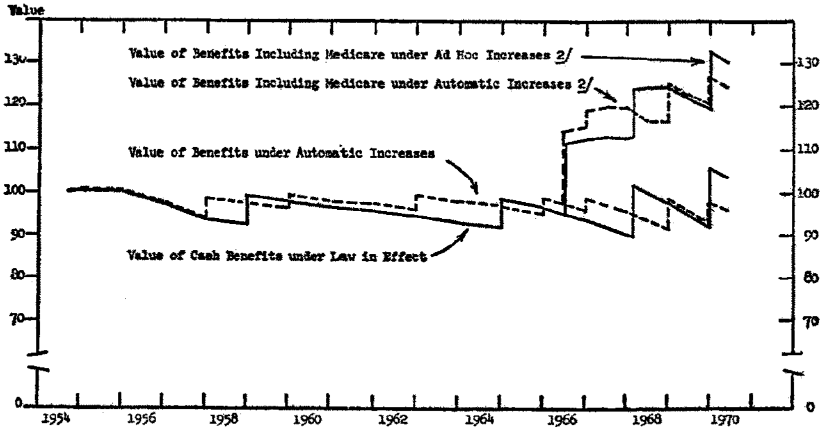
Value of Benefits Since 1950
Under the Increases Enacted Since 1950
And under an Assumed Automatic Adjustment System 1/



1/ It is assumed that the Administration's proposal for automatic adjustment of benefits to increases in prices was in effect since 1950.

CHART III

Value of Benefits Since 1954 under the Law in Effect Since 1954 and under an Assumed Automatic Adjustment System 1/



1/ It is assumed that the Administration's proposal for automatic adjustment of benefits to increases in prices was in effect since 1954.

2/ This value of Medicare is an average and will vary greatly from individual to individual. Medicare benefits are available only for people age 65 and over; one-third of the nearly 26 million social security beneficiaries are under age 65.

7/10/70

TABLE I.—HISTORY OF PERCENTAGE INCREASES IN BENEFITS AND PRICES, JANUARY 1940 TO JANUARY 1971

			Across-the-board increases in benefits		Average increase for all beneficiaries		Increases in CPI [1]	
Act	Date of Enactment	Effective date	Each Amendment (percent)	Cumulative (percent)	Each amendment (percent)	Cumlative (percent)	Between the Effective dates (percent)	Cumulative (percent)
1939	Aug. 10, 1939	January 1940						
1950	Aug. 28, 1950	September 1950	77	77	81.3	81.3	75.5	75.5
1952	July 18, 1952	September 1952	[2] 12.5	99.1	[3] 14.1	106.9	9.3	91.8
1954	Sept. 1, 1954	September 1954	13	125.0	13.3	134.3	0.5	92.8
1958	Aug. 28, 1958	January 1959	[4] 7	140.8	7.7	152.4	7.9	108.0
1965	July 30, 1965	January 1965	[5] 7	157.6	7.7	171.9	7.9	124.5
1967	Jan. 2, 1968	February 1968	13	191.1	14.2	210.5	9.3	145.4
1969	Dec. 30, 1969	January 1970	15	234.8	15.6	258.9	10.8	171.8
1970		January 1971	5	251.5	[6] 5.2	[6] 277.6		

[1] 1957–59 equals 100 percent.
[2] Greater of 12.5 percent or $5.
[3] 15.2 percent for old-age beneficiaries.
[4] Guarantee of 7 percent or $3.
[5] Guarantee of 7 percent or $4.
[6] Estimated.

Reference: Actuarial notes No. 10, No. 23, and No. 42.

2. Adoption of the automatic cost-of-living increase provisions would not eliminate the time lag between benefit increases and rises in the cost of living. Under the House-passed bill, benefits could be increased only once a year on the basis of the increase in the average Consumer Price Index for the third quarter of the preceding year.

3. The automatic cost-of-living provision will not take social security out of the political arena. Even if the provision is enacted, Congress will still have to make periodic reviews of the program to see that benefits keep up with changing economic conditions, such as changes in standards of living.

The House-passed proposal might be unstable. A similar provision was originally in effect for the civil service retirement program but it was liberalized so that increase could be provided more often than once each year and the benefit increases are now established at 1 percent more than the percentage rise in the CPI.

4. An automatic cost-of-living provision would maintain the real value of benefits, but might preclude or retard increases in the real value of benefits.

As of January 1970, the real value of benefits was 123.10 percent of the 1940 value. However, had the automatic provisions of the House-passed bill been in effect over the same period, the real value of benefits would be only 97.78 percent of the 1940 value.

As of January 1970, the real value of benefits was 122.12 percent of the 1950 value. However, had the automatic provisions been in effect over the same period, the real value of benefits would be only 100.03 percent of the 1950 value.

As of January 1970, the real value of benefits was 105.56 percent of the 1954 value. However, had the automatic provisions been in effect over the same period, the real value would be only 97.50 percent of the 1954 value.

5. An automatic cost-of-living provision requires setting aside a significant portion of anticipated future additional income to meet the cost of the increases. Thus, funds might not be available for other improvements in the program that might seem more desirable. In the past, as in the House-passed Social Security Amendments of 1970, the Congress has devoted a portion of expected revenues to improvements in the social security program other than across-the-board benefit increases (for example, raising of the earnings limitation, increasing widow's benefits, or liberalizing the disability insurance program).

6. Under an automatic provision, benefit increases may come at a time when it is not advisable to increase benefits. For example, under the economic policies adopted during World War II it was not thought desirable to increase social security benefits. However, had the provisions of the House-passed bill been in effect, benefits would have been increased in 1942, 1943, and 1944.

7. The provisions of the House-passed bill would provide increases in benefits as the cost of living rises. It would not, however, call for decreases whenever the cost of living drops. Therefore, if prices were to decrease, the relationship between benefit levels and the cost of living would be changed.

B. Automatic Increases in the Tax Base

The Following Arguments Have Been Advanced in Favor of the Proposal:

1. In order to spread the cost of social security benefits over all of the working population, the tax base needs to be increased from time to time as earnings levels increase. If the base is not increased as earnings rise, the cost of the program falls more heavily on people at the lower earnings levels. A provision calling for automatic increases in the tax base as earnings rise is the simplest way of assuring that the base will rise.

2. If the tax base is not increased as earnings levels rise, more and more people will be earning at or near the maximum amount taxable. Because the tax base is also the limit on earnings that may be used to compute benefits, the program would tend to pay flat benefits, rather than wage-related benefits. The provision for automatic increases in the tax base will assure that benefits remain wage related.

3. Automatic increases in the tax base are needed to meet the cost of increasing benefits as the cost of living goes up. If the base is not increased, tax rates would have to be increased.

4. The tax rates in the bill reported by the House Ways and Means Committee for the hospital insurance part of the program were predicated on the assumption that the tax base would increase as average covered earnings rise. However, the Committee on Ways and Means did not write into the bill an escalating tax base. The House floor action, however, wrote into the bill, in effect, this part of the actuarial assumptions on which the hospital insurance tax rates are predicated.

5. Congress has clearly established a policy of adjusting the tax base as earnings levels rise. The provision for automatic increases in the tax base writes into law the already established congressional policy.

The Following Arguments Have Been Advanced Against the Proposal:

1. Although Congress has seen fit to increase the tax base from time to time to take account of increases in earnings levels, it has not established as a principle the idea that there should be any fixed relationship between earnings and the base. If the automatic provisions of the House-passed bill had been in effect from 1940, the base would have reached the present $7,800 level in 1953 (in 1953 the base was $3,600), and would now be $14,400. (Table II shows the effect of automatic increases had such a provision been in force from 1940.)

TABLE II

Comparison of Ad Hoc Increases in the Contribution and Benefit Base with the Automatic Increases Which Would Have Taken Place if the Provisions of H.R. 17550 Had Been Effective in 1940

Year	Contribution and benefit base	
	Ad hoc increases	Automatic adjustment
1940	$3,000	$3,000
1941	3,000	3,000
1942	3,000	3,000
1943	3,000	3,600
1944	3,000	3,600
1945	3,000	4,800
1946	3,000	4,800
1947	3,000	4,800
1948	3,000	4,800
1949	3,000	6,000
1950	3,000	6,000
1951	3,600	6,600
1952	3,600	6,600
1953	3,600	7,800
1954	3,600	7,800
1955	4,200	8,400
1956	4,200	8,400
1957	4,200	9,000
1958	4,200	9,000
1959	4,800	9,600
1960	4,800	9,600
1961	4,800	10,800
1962	4,800	10,800
1963	4,800	11,400
1964	4,800	11,400
1965	4,800	12,000
1966	6,600	12,000
1967	6,600	13,200
1968	7,800	13,200
1969	7,800	14,400
1970	7,800	14,400

The determination of the appropriate tax base for any year is a pragmatic judgment based on an evaluation of what is needed and what is feasible. Inasmuch as this is a value judgment, it will vary with time and individuals. For example, in the past the administration's recommendation for tax base increases have been higher generally than the Congress was willing to provide. In one case, however, the Congress provided a higher increase than the administration originally suggested. In 1967 the Congress provided the immediate increase recommended, but did not accept the recommendation that two future increases be written into the law. (Table III compares the tax bases recommended by the administration since 1950 with the bases provided in the law.) The House-passed provisions would do away with the pragmatic and ad hoc approach of the past.

TABLE III.—ADMINISTRATION RECOMMENDATIONS FOR CONTRIBUTION AND BENEFIT BASE CHANGES SINCE 1950

Year	Administration recommendation	Enactment
1950	$4,800, effective January 1950 (H.R. 2893)	$3,600, effective January 1951 (Public Law 81–734).
1954	$4,200, effective January 1955 (H.R. 7199)	$4,200, effective January 1955 (Public Law 83–761).
1958	$4,800, effective January 1959 (testimony of Secretary of Health, Education, and Welfare before Ways and Means Committee, June 16, 1958).	$4,800, effective January 1959 (Public Law 85–840).
1964	$5,200, effective January 1965 (H.R. 3920 which also provided for medicare benefits).	Not enacted.
1965	$5,600, effective January 1966 (H.R. 1)	$6,600, effective January 1966 (Public Law 89–97).
1967	$7,800, effective 1968 (H.R. 5710); $9,000, effective 1971; $10,800, effective 1974.	$7,800, effective January 1968 (Public Law 90–248).
1969	$9,000, effective January 1, 1972 with automatic increases thereafter.	House passed bill (H.R. 17550); $9,000, effective January 1, 1971.

2. The House-passed bill would weaken the congressional taxing power—a power reserved to the Congress under the Constitution—by substituting an administrative determination of when a tax base increase would occur in place of a congressional judgment in each specific case. Under the provision, absent any congressional action to forestall a specific increase, the tax base would rise according to a mechanistic determination.

3. The increases in the tax base would occur regardless of whether they are in line with other broader policy objectives. Had the House-passed provision been in effect during World War II, the tax base would have gone from the original $3,000 to $3,600 in 1943 and to $4,800 in 1945. During World War II, the established policy was to hold down social security taxes. In that period, social security tax rates were scheduled to increase, but Congress acted to prevent the increases from going into effect. If an automatic tax base increase provision had been law at that time, Congress might have taken similar action to postponse tax base increases, but the action would have been complicated by the relationship between the cost-of-living benefit increases which would have gone into effect in 1942, 1943, and 1944 and the tax base increases needed to pay for them.

4. Although the importance of social security taxes in the Federal economy is generally recognized, there has been no analysis of the effect of the proposed automatic increases in the social security tax base on the cost of labor in future years. The automatic wage base increase assures, however, that the cost of labor will increase over the years. At the same time, the cost of automation or other labor substitutes will not be subject to an automatic increase in the future.

Similarly, the impact of the automatic tax base increase on the consolidated Federal budget has not been studied. The Special Analyses of the Budget for fiscal year 1971 indicates the growing importance of social security taxes with the following sentence:

> In 1967, social insurance contributions exceeded corporate profits tax accruals, and thus became the second largest category of Federal sector receipts.

For fiscal 1971, the budget estimated that social insurance contributions would amount to 25.8 percent of the total Federal sector receipts.

In 1946 social insurance contributions amounted to only 2.4 percent of personal income while for fiscal 1970, they were estimated to amount to 6.2 percent.

5. The actuarial study of the cost of the automatic cost-of-living provisions and the income from the automatic increases in the tax base has not been completed and, therefore there is no prediction

as to trust fund balances for the long-range future. As a matter of fact, the Social Security Administration actuaries have not yet projected the revenue and cost effect—either in dollars or expressed as a percentage of taxable payroll—of the automatic benefit and tax base increase provisions over the 75-year actuarial period. Their projections of the long-range actuarial social cost of the security cash programs assume only one automatic benefit increase over the next 75 years, to take place in 1973. The information furnished to the committee up to this time indicates that the increases in the tax base (see table IV for the anticipated increases) will pay for the automatic benefit increases if average covered earnings increase at twice the rate the cost of living increases. If earnings go up at less than the predicated ratio to prices (2 to 1), then the benefit increases will be underfinanced. If the rate is higher, the benefit increases will be overfinanced. In the past, the ratio of average covered earnings to the Consumer Price Index has varied widely, depending on the period over which it is measured. The staff has not found any significant period in which the ratio was 2. For the period 1940–68, the ratio was 2.5; for 1940–50 it was 1.2; for 1950–68 it was 3.3; and for 1965–68 it was 1.7.

TABLE IV

PROJECTED WAGE BASE AND EMPLOYER-EMPLOYEE COMBINED TAX RATE

Year	Present Law wage base	H.R. 17550 wage base	Year	Present Law wage base	H.R. 17550 wage base
1970	$7,800	$7,800	1981 to 82	$7,800	$13,800
1971 to 72	7,800	9,000	1983 to 84	7,800	15,000
1973 to 74	7,800	10,200	1985 to 86	7,800	16,200
1975	7,800	10,800	1987 to 88	7,800	18,000
1976	7,800	10,800	1989 to 90	7,800	19,200
1977 to 78	7,800	12,000	1991 to 92	7,800	21,000
1979	7,800	13,200	1993 to 94	7,800	22,200
1980	7,800	13,200			

While it seems reasonable to anticipate that the income to the program will rise as average earnings rise, it is difficult to predict the degree of the rise except for a relatively short period. In the past it has been thought adequate to provide sufficient income for the short-range future and on the basis of reasonable assumptions about what would happen in the longer range future to set long-range tax rates. The automatic provision makes assumptions as to what will happen in the future in a way that is difficult to evaluate for legislative planning. For example, it seems certain that under the automatic tax base increase provision the trust funds will receive more income than was anticipated in the earlier estimates. It is by no means clear, though, how much more income there will be nor how much more expenditures will rise under the provision for cost-of-living benefit increases.

In the past it has been possible to predict with a fair degree of certainty that, absent any legislation, increases in earnings levels would result in increased trust fund balances. Under the automatic provisions there would be no way of anticipating whether the trust fund would be in actuarial balance or not.

6. The existing actuarial information indicates some uncertainty about the cost-income effects of the automatic benefit and tax base increases. The former Chief Actuary of the Social Security Administration made a preliminary estimate that the combined effect of the

automatic provisions would have a net saving somewhere in the neighborhood of 0.05 percent of taxable payroll. Subsequently, the Deputy Chief Actuary estimated that there would be a saving of 0.11 percent of taxable payroll. Still later, the Commissioner of Social Security indicated to the committee in public hearings that he "felt that there is not enough certainty" that the 0.11 percent saving would result and that he preferred "to be on the conservative side". This position was ratified by the Deputy Chief Actuary in a memorandum in which he said:

> We believe that under the House bill, it would be more desirable to consider the "savings" of 0.11 percent of payroll as a reasonable margin of safety rather than to reduce the cost of the modified program.

The memoranda from the actuaries are reproduced in the appendix

7. Medicare benefits under the House-passed bill would not change in future years, but taxes on the wages of persons earning more than $9,000 would pay nearly all of the increased costs after 1972.

C. Automatic Increases in the Retirement Test

The Following Arguments Have Been Advanced in Favor of the Proposal:

1. As earnings rise, the exempt amount in the retirement test becomes less meaningful unless it is increased from time to time. Thus, an automatic provision geared to rises in covered earnings is an appropriate way to update the exempt amount.

The Following Arguments Have Been Advanced Against the Proposal:

1. The appropriate level of the retirement test exempt amount is not a function of a single economic indicator such as average covered earnings. Rather, the appropriate determination of the exempt amount should depend on an evaluation of a number of factors which indicate whether a person has in fact "retired" and what the part-time earnings of an average retired person might be. If the House-passed provision had been in effect from 1940, the monthly exempt amount would be $81.10, rather than the present $140 a month. On the other hand, had the provision been in effect from 1954, the exempt amount would be $180 a month. (Table V shows the exempt amounts that would have been in effect from 1940.)

TABLE V.—ILLUSTRATION OF THE RETIREMENT TEST MONTHLY EXEMPT AMOUNT ASSUMING THE PROPOSED AUTOMATED ADJUSTMENT PROVISION IN H.R. 17550 HAD BEEN ENACTED IN 1940

Year adjustment effective	Average annual wages	Monthly exempt amount	Annual exempt amount
1940	$1,008	$14.99	
1942	1,110	16.49	
1948	1,890	28.11	
1954	2,844	42.29	$507.48
1960	3,557	52.88	634.56
1966	4,359	64.82	777.84
1970	5,456	81.10	973.20

[1] Annual exempt amount instituted in 1951 for the self-employed and in 1955 for wage earners.

III. THE AUTOMATIC INCREASE PROVISIONS AS PASSED BY THE HOUSE OF REPRESENTATIVES

The Social Security Amendments of 1970 (H.R. 17550) were debated in the House of Representatives under a closed rule which limited debate and permitted only amendments sponsored by the Committee on Ways and Means and one motion to recommit the bill. Toward the end of the debate, a motion was made to recommit the bill with instructions to report forthwith an amended bill containing provisions calling for automatic increases in benefits as the cost of living rises, automatic increases in the tax base as average wages in covered employment rise, and automatic increases in the earnings test exempt amount as average wages in covered employment rise.

A. Benefit Increases

Under the House-passed bill, social security benefits would be increased (but not decreased) according to changes in the consumer price index (CPI) which occur after September 1971, with the first cost-of-living increase possible no earlier than January 1973 and subsequent increases possible each January thereafter. No increase, however, would be made unless the CPI had risen by at least 3 percent above the CPI for the base period used for the last annual determination.

The Secretary of Health, Education, and Welfare would be required to make an annual computation of what the rise in the CPI had been and on the basis of this computation, determine whether a cost-of-living benefit increase was called for. The first of these computations would be made after September 30, 1972, and before December 1, 1972. In making his determination of whether benefits should be increased, and how much the increase should be, the Secretary would compare the average CPI for the third calendar quarter of 1971 with the average CPI for the third calendar quarter of 1972. If the computation shows an increase of at least 3 percent for 1972 over 1971, then benefits would be increased for the following January by the percentage rise in the CPI, rounded to the nearest one-tenth of 1 percent. This increase would apply to all people who are entitled to benefits for January and to all who become entitled to benefits in the future. If the increase in the CPI should be less than 3 percent, there would be no benefit increase. In the latter situation, the Secretary would make a new determination after September 1973, and before December 1973, with the CPI for the third quarter of 1973, and the increased benefits, assuming a rise in the CPI of at least 3 percent, would be effective for January 1974.

In addition to the cost-of-living increases, the Secretary would also extend the schedule of benefits (according to the method described in the bill) to take into account any increases in the tax base (which also determines the maximum amount of earnings that can be used in benefit computations) which might be effective as a result of increases resulting from the provision (described below) for automatic increases in the tax base.

B. Increases in the Tax Base

The House-passed bill would increase the tax base from $7,800 a year to $9,000. The increase, however, would be effective only for the years 1971 and 1972, with future tax bases dependent on the rise in average taxable earnings under the social security program. The Secretary of Health, Education, and Welfare would be required to determine when average taxable earnings had gone up sufficiently to require tax base increases in multiples of $600. The first of these determinations would be made before November 1, 1972, and the first rise in the tax base could be effective for 1973. Subsequent determinations would be made in each even-numbered year and would be effective for the next following odd-numbered year, i.e., the determination made in 1972 would provide the base for 1973 and 1974 and the determination made in 1974 would provide the tax base for 1975 and 1976, et cetera.

For the first determination of the tax base the law provides the following formula:

1. $9,000 multiplied by:

   (*a*) the average taxable wages reported to the Secretary for the first calendar quarter of 1972, divided by:

   (*b*) the average taxable wages reported to the Secretary for the first calendar quarter of 1971;

2. If the resulting amount is $300 or more, but less than $900, the base would be increased by $600.

Subsequent determinations would be based on a similar formula. The 1974 determination would be based on the product of $9,000 multiplied by the ratio of first quarter average taxable wages for 1974 to similar wages for the first quarter of 1971.

While the provision would increase the tax base as average covered earnings rise, it also provides that once the base is raised it would not be reduced, regardless of whether average taxable earnings decrease

C. The Earnings Test

In addition to increasing the amount that a person can earn and still receive all of his social security benefits from $1,680 a year ($140 a month) to $2,000 a year ($166.66⅔ a month), the House-passed bill would provide for automatic increases (but not decreases) in this amount. The first of these increases could be effective for 1973.

The method of determining these increases is similar to that for increasing the tax base and each determination would be effective for at least 2 years. The first determination would be made not later than November 1, 1972, with subsequent determinations being made in each even-numbered year and going into effect in the following odd-numbered year.

IV. COST-OF-LIVING PROVISIONS IN OTHER FEDERAL PROGRAMS

At the present time, the Federal military and civilian retirement programs and the Federal employees compensation program provide for automatic increases in benefits to take account of rises in the cost of living. In each of these programs, monthly benefits are increased whenever the CPI rises by at least 3 percent and maintains a 3-percent rise for 3 consecutive months. In none of the programs are benefits decreased if the CPI falls.

A. Military Retirement

The first Federal legislation providing for benefit recomputations related to rises in the cost of living was adopted in 1958 with respect to military retirement pay. From 1861 until 1922, military retirement pay was based on active duty pay, rising as active duty pay rose and falling as active duty pay fell. From 1922 to 1926, the law made no provision for recomputation of retired pay and in 1926, the earlier recomputation provision was reinstated. This situation continued up to 1958 when a cost-of-living provision was adopted in place of increases (or decreases) based on changes in active duty pay.

B. Civil Service Retirement

Following the adoption of the 1958 military retirement legislation, a cost of living provision was added to the civil service retirement system. The provision adopted for the civil service program, and subsequent changes, has become the standard for all programs which cover Federal employees.

Under the 1962 legislation civil service benefits payable at the beginning of 1963 were increased by 5 percent with smaller increases for people becoming entitled to benefits in each of the next 4 years and automatic increases based on rises in the CPI were authorized. Under this provision, benefits were to be increased whenever the cumulative rise in the annual average CPI was at least 3 percent. These benefit increases were to be effective for April of the year following the year in which the rise in the CPI reached the 3-percent mark. The base year for the first rise was 1962, and a new base year was to be established each time there was a cost-of-living increase in benefits.

The 1962 Act was amended in 1965 to provide a general benefit increase and cost-of-living increases whenever the CPI rose by at lease 3 percent above the CPI for the base month and remained at or above the 3 percent mark for 3 consecutive months. When this rise occurred, benefits for the third month after the end of the 3-month period were to be increased by the amount of the percentage rise in the CPI. This provision has resulted in a number of benefit increases, the latest being a 5.6-percent increase (under a 1969 modification) effective for August 1970.

In 1967 the law was amended so as to assure that people with the same basic pay and length of service would receive equal retirement benefits regardless of whether they retired before or after a cost-of-living increase. Under this provision, the initial benefit reflects the rise in the CPI between the last pay increase and the most recent cost-of-living increase before retirement.

In 1969 the law was amended again to provide that each cost-of-living increase would be 1 percent higher than the rise in the CPI which triggered the increase.

C. Federal Employees' Compensation Act

The Federal Employees' Compensation Act provides for payments to Federal employees who sustain work-related injuries. In 1966, a cost-of-living provision was added to the law which applied to benefits based on injuries or deaths occurring at least 1 year before the effective date of the benefit increase. Otherwise, the provision is identical to the civil service provision.

D. Comparison With Social Security Proposal

Table VI compares the provisions of the proposed cost-of-living provision for social security with the provisions currently in effect for other Federal programs.

TABLE VI

COMPARISON OF COST-OF-LIVING INCREASES IN SOCIAL SECURITY BENEFITS PROPOSED UNDER H.R. 17550 AS PASSED BY THE HOUSE WITH EXISTING PROVISIONS OF OTHER MAJOR PROGRAMS

Item	Military retirement	Civil service and other Federal retirement programs	Federal employees' compensation	Social Security proposal
Base period	1 month	1 month	1 month	¾ of each calendar year.
Period over which 3-percent increase in CPI is required.	3 consecutive months	3 consecutive months	3 consecutive months	Average for third calendar quarter.
Benefit increase	Percent rise in cost of living, plus 1 percent.	Percent rise in cost of living, plus 1 percent.	Percent rise in cost of living (at least $1).	Percent rise in cost of living.
Applies to	People retired before effective date of increase.	People retired before effective date of increase.	Injuries occuring 1 year before effective date of increase.	All social security beneficiaries, both those entitled on effective date of increase and those becoming entitled in the future.
Effective date of increase	3d month after 3-month period	3d month after 3-month period	3d month after 3-month period	Following January.
Financing	None [1]	None [2]	None [1]	Through automatic increases in tax base related to rises in average taxable wages.

[1] Program is financed out of general revenues.
[2] Increases unfunded liabilities, which are financed out of general revenues.

V. APPENDIX

MAY 22, 1970.

Memorandum from: Robert J. Myers.
Subject: Actuarial balance of OASDI system under H.R. 17550 as passed by the House of Representatives.

The actuarial balance of the OASDI system as it would be modified by H.R. 17550 as it was reported by the House Ways and Means Committee was −0.12% of taxable payroll, or slightly in excess of the traditionally accepted limit of −0.10% of taxable payroll.

The bill, in essence, was amended on the floor of the House so as to incorporate automatic adjustment provisions for the earnings base, the benefit amounts, and the earnings test—on a basis somewhat similar to what the administration had recommended last fall. In addition, the floor action changed the basis of the earnings test, so that the "$1 for $2" reduction band apply indefinitely above the $2,000 annual exempt amount (instead of only to the first $1,200 of earnings above the annual exempt amount, as in present law and as in the committee bill).

The change in the basis of the earnings test increases the estimated level-cost of the system by 0.03% of taxable payroll. It would thus, at first, appear that the actuarial imbalance increased—to −0.15% of taxable payroll. However, this is not the case because the manner in which the automatic adjustment provisions are carried out produces a small cost savings that would probably bring the actuarial balance down to −0.10 percent of taxable payroll, or less.

Under the original administration proposal for the automatic-adjustment provisions, which I have estimated to be on a "no cost" basis under reasonable assumptions as to the future trend of the general earnings level and the cost of living, I had presumed that the first automatic adjustment of benefits would occur for January 1972 (based on the change in the cost of living between 1970 and 1971) and that the first increase in the earnings base would be for 1973 (based on the change in earnings in the 2-year period from 1970 to 1972—a 2-year period being used because future changes in the earnings base would be made every 2 years, rather than annually as for the benefit changes). Under the bill actually passed by the House, the first benefit increase is for January 1973 and the increase in the earnings base for 1973 is, consistently then, based on a 1-year increase in the general earnings level. The net result of this 1-year deferral of the benefit increase (which has a perpetual effect on the benefit level) and the use of a 1-year period in determining the first increase in the earnings base (which again has a perpetual effect) is a small net savings. This is partially the case because of the general nature and relationship of the adjustment procedure and in part because of the relatively unfavorable relationship (insofar as OASDI costs are concerned) between the general level of earnings and the cost of living at the current time.

JUNE 12, 1970.

Memorandum from: Francisco Bayo, Deputy Chief Actuary.

Subject: Change in actuarial balance of the OASDI system under H.R. 17550 as approved by the House.

The attached table contains an itemized analysis of the actuarial significance, as expressed by the estimated level-cost, of changes over the present OASDI system proposed in H.R. 17550 as passed by the House.

All items are based on the same intermediate-cost long-range (75-year) level-cost concept expressed as a percent of taxable payroll that has been used in the past to judge the financial soundness of the system. It is estimated that over the long-range future, after 1972, under the automatic adjustment provisions taxable earnings will increase *at twice the rate of the Consumers Price Index* and that there will be no additional cost (or "savings") to the system over that period because of these provisions.

CHANGE IN ACTUARIAL BALANCE OF OASDI SYSTEM, EXPRESSED IN TERMS OF ESTIMATED LEVEL-COST AS PER CENT OF TAXABLE PAYROLL, INTERMEDIATE-COST ESTIMATE, PRESENT LAW AND H.R. 17550 AS PASSED BY HOUSE

Item	OASI	DI	Total
Actuarial balance of present system	−0.08	0	−0.08
Effect of using 1970 earnings	+.25	+.03	+.28
$9,000 earnings base in 1971	+.20	+.03	+.23
Age-62 computation point for men	−.12	(1)	−.12
Earnings test change	−.13	(1)	−.13
Widow's benefit 100 percent PIA at 65	−.24	(2)	−.24
Elimination of actuarial reduction when shifting from one benefit to another	−.10	(1)	−.10
Miscellaneous changes[3]	−.01	−.01	−.02
Benefit increase of 5 percent	−.43	−.05	−.48
Automatic adjustments in benefits and earnings base	+.10	+.01	+.11
Revised contribution schedule	+.51	.00	+.51
Total effect of changes in bill	+.03	+.01	+.04
Actuarial balance under bill	−.05	+.01	−.04

[1] Less than 0.005 percent.

[2] Not applicable to this program.

[3] Includes the following: child's benefits for children disabled at ages 18 to 21; workmen's compensation offset based on 100 percent of "average current earnings" as maximum; elimination of support requirement for divorced wife's and widow's benefits; reduced widower's benefits at age 60, and liberalization of insured status requirements for disability benefits with respect to blind persons.

AUGUST 12, 1970.

Memorandum from: Francisco Bayo, Deputy Chief Actuary, SSA.

Subject: Effect on the actuarial balance of the OASDI system of the automatic adjustment provisions in H.R. 17550.

The actuarial balance of the OASDI system under H.R. 17550 as passed by the House has been estimated to be −0.15 percent of taxable payroll. This estimate is based on assumptions with respect to the automatic adjustment provisions which are somewhat more conservative than those used to estimate the cost of the proposal as originally presented to the House of Representatives.

The automatic provisions which were originally presented to the House of Representatives involved automatic benefit increases beginning with the second year after enactment and automatic adjustments in the earnings base every 2 years beginning with the the third year after enactment. As compared to them, the provisions in H.R. 17550 would have a lower cost since the first benefit increase would be in the third year after enactment (rather than the second year). This lower cost would be partially offset by an increase in cost due to changes in the provisions for keeping the earnings base up to date (the first increase is for only 1 year instead of 2 years), but the net result would be a set of provisions in the current bill (H.R. 17550), which would cost less than those in the bill that was considered by Congress last fall.

The original proposal was estimated to have no cost in terms of percentage of payroll on the assumption that over the long-range future earnings would increase approximately twice as fast as the Consumer Price Index. On the same assumptions, the House provisions would result in a "saving" over present law of 0.11 percent of payroll after taking into account, as indicated below, the effect of higher increases in the CPI in the near future.

This "savings" as compared with the original proposal is the result of three different components. A decrease in cost of 0.42 percent of taxable payroll due to the lack of a benefit adjustment in 1972 under the terms of H.R. 17550, an increase in cost of 0.12 percent of taxable payroll due to only 1 year of earnings increase taken into account in the 1973 earnings base adjustment, and an increase in cost of 0.19 percent of taxable payroll due to projected CPI increases in the near future that are higher than what could be financed by the projected increases in taxable earnings. These estimates are based on an assumption that the CPI will increase by 4 percent in 1971 and 3 percent in 1972 and that wages would increase by 5.4 percent and 5.0 percent, respectively.

We believe that under the House bill it would be more desirable to consider the "savings" of 0.11 percent of payroll as a reasonable margin of safety rather than to assume that the automatic provisions will actually reduce the cost of the modified program.

Another way of looking at this matter is to assume that, even though over the long run wages would increase at about twice the level of prices, for the short run there may well be a significant period in which increases in prices and wages are much closer together. Thus, if we were to assume that the CPI would increase by 4 percent in 1971 and by 3 percent in 1972, 1973, and 1974 while earnings increase by 5.4 percent in 1971 and 5 percent in 1972 through 1974 before arriving at the 2-for-1 ratio, then the automatic provisions of H.R. 17550 would be without cost or saving as a percentage of payroll. If the 2-to-1 ratio is actually reached sooner, then, of course, there would be a saving to the program which could be taken account of at that time.