

### Chapter 3

## ALTERNATIVES TO SOCIAL SECURITY

As directed by Congress, the Commission studied alternatives to the present Social Security system to determine if any of them could accomplish the same objectives or serve the same functions as effectively as the present system. The Social Security program is designed to provide a secure source of continuing income to persons who have lost income from earnings because of retirement, disability, or the death of a family worker. Social Security does this by relating benefits to a person's previous earnings, thus automatically assuring an adjustment to differing wage patterns in different parts of the country and a reflection of the individual's standard of living in his working years.

#### Individual Responsibility

In considering alternatives, a basic question is whether any organized social insurance system is needed. Some argue that provision for future contingencies should be left to the individual. In the years since the Social Security system was established, there has been a substantial expansion in private insurance, particularly in the

availability of group insurance and private pension plans.<sup>1/</sup> The Commission recognizes the importance of such private arrangements and regards them and other forms of private savings as essential supplements to Social Security. It is not persuaded, however, that they could be used as an acceptable substitute.

The primary difficulty with reliance on voluntary savings is that too many people not only will not save, but also do not have an institutional basis for saving. It is not surprising that families hard pressed for funds to cover current needs--and seeing little prospect that monies put aside now will retain their value many years hence--choose to spend their money now. The growth in private insurance has come through employee benefit plans developed by employers or unions. Such plans are not readily available, however, to significant segments of the labor force, especially those who work for firms whose work force, revenues, and assets are small.

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<sup>1/</sup> About half of all workers in private non-agricultural employment are now covered by private pension plans. The growth in such plans was rapid from 1940 to 1960 but has since tapered off. The President's Commission on Pension Policy, An Interim Report, May 1980.

All individual savings lack the insurance element that is an important aspect of income security. If family savings must be spent because of illness or disability, they will not be available in old age. Non-group private retirement programs are beyond the financial ability of most low-income and many middle-income families. Again, the Commission regards private savings as an important part of the total income security of American families; it recommends a strengthening of present Individual Retirement Account (IRA) opportunities. Present law permits a maximum tax deductible contribution of \$1,500 per year to a qualifying Individual Retirement Account. The Commission believes that this amount should be increased as a way to encourage savings (see Chapter 7). But these savings programs should be regarded as supplements to a Social Security system that makes available to all workers a way of insuring against a broad range of contingencies and that maintains the real value of the protection through indexing--adjusting the value of benefits to reflect changes in prices over time..

#### Means-Tested Assistance Payments

One alternative that has been proposed in slightly different forms over the years and that should be considered in any fundamental review is to limit the public program so that public funds are used only to assist people who are currently in need. The definition of need can be generous or restrictive, and could vary over time or between regions of the country,. In any case, income support and assistance would be given only to individuals or families whose current income and assets are below specified amounts.

Public assistance for those whose current incomes are below a socially-acceptable minimum level is an essential and accepted principle in our society. In Chapter 12, a number of recommendations are made which are designed to strengthen and improve one such program--the Supplemental Security Income program. The Commission does not believe, however, that exclusive reliance on means-tested programs is a desirable or viable alternative to the Social Security system.

People do not like to ask for help, and have their individual circumstances examined, so some suffer deprivation rather than turn to public assistance, no matter what it is called. If the only security when employment and earnings fail were a means-tested program, it might indicate to many people that saving is not worthwhile, because any income saved would substitute for, rather than supplement, the public program benefits.

At the present time, some 2 million Social Security beneficiaries--6 percent of all those getting benefits--are receiving' assistance under Supplemental Security Income. There will always be some individuals who have had multiple misfortunes or who never had an adequate income during their working lives who will need assistance when they become disabled or reach retirement age. Others will face special circumstances and needs which require special assistance.

There are an estimated 7 million beneficiaries aged 65 and over and 11 million of all ages whose incomes would be below the current poverty line if they did not receive a Social Security benefit. Assuming that many of these would go on public assistance, the additional load if Social Security were abolished would overwhelm

the public assistance system and require large appropriations from Federal, State, and local treasuries. It is preferable to prevent this need from arising through a contributory program of social insurance.

#### Universal Pensions

Another approach that has been followed in some countries and is occasionally advocated for the United States would pay a universal flat benefit from public funds to all persons over a stated age, or to all over that age who are retired. These payments would be made without regard to current income and assets or to previous employment. Because the universal benefit would go to everyone who meets the age qualification, no eligibility tests related to previous contributions or current income would be required. Everyone would be assured of some income in old age.

One witness<sup>2/</sup> who testified before the Commission recommended replacing the present Social Security system with a universal pension payable at a stated age--eventually age 70. Under this plan, people's ability to retire before age 70 would depend on whether or not they had saved and the arrangements made with their employers. The universal benefit would be set at a level somewhat above bare

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<sup>2/</sup> A. Haeworth Robertson, former Chief Actuary of the Social Security Administration. His views are developed further in Social Security: Prospect for Change, commentary presented at Annual Meeting of Chamber of Commerce of the United States, May 1, 1978, William Mercer, Inc.

subsistence; it would be adjusted for inflation and perhaps for geographic variations in the cost of living, and would be subject to the Federal income tax. The plan presumes the existence of "an appropriate health care program for the aged" and postulates the existence of a separate disability insurance program, with heavy emphasis on rehabilitation and retraining. It further assumes the availability of jobs and of manpower policies which encourage retraining, job modification and geographical relocation of jobs and people.

The advantages of the universal old-age pension, as seen by its advocates, are its simplicity and its emphasis on individual choice. People would decide for themselves whether to save more and retire early or to save less and retire later. Employers who provide pensions to their employees would need to provide them for a short period of time. After age 70 the universal pension would, they believe, provide adequate financial security, even though some employers might continue to provide discretionary benefits after the fixed retirement age. The manpower policies implied should result in a more complete utilization of the Nation's human resources.

The Commission agrees that economic and manpower policies which would make possible and encourage continued employment of older workers are desirable. Detailed recommendations relating to the retirement age, which the Commission believes should encourage later retirement, are discussed in Chapter 5. Whatever the age of eligibility, the Commission does not believe that a universal flat pension can provide the diversity required in this country.

Although the Scandinavian countries and Canada have universal pension systems, they supplement the universal flat pension with an earnings-related benefit for those who had earnings.

The universal flat pension reflects a sense of community responsibility and, if set at an adequate level, could replace most means-tested payments. However, it is not likely to be acceptable to the middle-income groups. The great majority of the working population, many of whom do not have private pensions or large amounts of private savings, wants an assured retirement income that will permit a standard of living not too far below their level attained while working. A flat grant cannot provide this income without extremely high costs to the Treasury.

#### Double-Decker Benefit Plans

A universal flat benefit plus an earnings-related benefit become a so-called "double-decker" system. Proposals have been made for many years for a double-decker system which would replace the current weighted benefit computation with a two-part computation--a flat-rate benefit plus a benefit strictly proportional to prior earnings.

The flat benefit would be financed from general revenues; the earnings-related benefits from the payroll tax. There would be no spouse's benefit because all persons would receive the flat payment. For the second deck, the system would be the same as the present Social Security system in terms of employment coverage, eligibility for the earnings-related benefits, definition of disability, retirement age, etc.

A double-decker plan could be devised which would provide approximately the same total benefits as the present system for most people. For persons with no earnings or very irregular earnings, it would provide at least a minimum payment. For those with substantial earnings, in many cases a benefit more directly related to previous earnings would be paid, in addition to the flat amount.

A double-decker system would solve many of the problems which arise from the diverse situations of women, without discriminating against women because of marital status. Most proposed changes in the existing benefit formula designed to deal directly with women's concerns adversely affect some groups while favoring others.

Shifting to a double-decker system would involve a number of special problems, such as provisions for early retirement if, as is usually assumed, the universal pension were paid only to persons aged 65 and over (or to the disabled).

Some analysts are concerned that, if a double-decker program were adopted, eventually the flat benefit would be subject to a means test. This would change the nature of the system and greatly deliberalize the protection afforded to workers unless the earnings-related benefit amounts were substantially increased.<sup>3/</sup> On the other

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<sup>3/</sup> There have been some proposals to apply a means test to the bottom deck of a double-decker system. The benefits paid on an insurance basis would no longer include a weighting for low earnings. In themselves, they would; in all probability, provide a very meager income for middle-income groups. Assistance for the neediest would highlight the contrasting treatment of those just above, and those just below, the poverty threshold.

hand, political pressures could result in a continued increase in the amount of the flat benefit and of its general revenue costs, and a concurrent diminution of the earnings-related benefit.

It is difficult to weigh these conflicting positions or to assign reasonable probabilities to future developments. The Commission is convinced, however, that the present system, combining elements of both individual equity and social adequacy, should be retained.

#### Choice of Public or Private System Coverage

It is sometimes suggested that workers should have the right to opt out of Social Security if they prefer coverage under a private plan. The proposals take different forms--some would require that the private plan be certified as providing equivalent protection while others stress individual choice.

When the original Social Security program was being considered in 1934 and 1935, there was strong pressure to exempt from coverage all workers covered by private pension plans and to permit future opting out. After considerable debate, Congress decided to retain compulsory coverage for Social Security and to encourage the development of supplementary private plans. The continuing mobility of the work force and the need to build up lifetime pension credits were important considerations. Private pension and other employee benefit plans became supplements to the basic public program and grew in size and numbers.

Today, any proposal for opting out of Social Security has to recognize the fact that there are no private plans which provide all of the protections which the Social Security system now provides. Almost

none guarantee to maintain the full purchasing power of benefits once awarded. The pension formulas of most private plans are designed to supplement Social Security.<sup>4/</sup> Private plan benefits could be modified in this respect, of course, but at a considerable cost, and with the other problems unresolved. Furthermore, the administrative complications of any regulated method of opting out by individual workers would be serious.

If people were permitted to choose not to participate in Social Security, certain groups would be likely to leave the program. One group would be those who need the tax money to meet day-to-day living costs--and who would be most in need of the protection of the program, even though they do not realize the value of the protection they are giving up. Another group likely to opt out would be those who have "low cost" characteristics (for example, the young, the single, and the high-paid) <sup>5/</sup> Those who remained in Social Security would tend to be relatively "high cost" persons. To the extent that

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<sup>4/</sup> Grad, Susan, Income of the Population 55 and Over, 1978, a forthcoming report of the Office of Research and Statistics, Social Security Administration, Tables 13 and 22.

<sup>5/</sup> High-paid persons tend to be "low cost," because of the effect of the weighted benefit formula. Similarly, single persons without children are "low cost," because there would be no family benefits available on their earnings records. Likewise, young persons are of a "low cost" nature because of the long period during which taxes will be paid on their behalf and because of the low probabilities of retirement, disability, and death for many years.

low cost individuals would opt out and high cost individuals would continue to participate in the program, its cost relative to taxable payroll would increase.

Because Social Security covers almost all people throughout their working lifetime, shifts in employment can mean larger or smaller supplementary benefit rights, but rarely a loss of basic protection. With Social Security as a base, private plans can develop in various ways, with priorities related to the special circumstances of an industry or firm. This relationship has thus far proved to be workable. The Commission believes that a system of opting out would be administratively complicated and costly, disadvantageous to most workers, and of no real advantage to private plans.

#### Retirement Bonds

The Congress directed the Commission to consider specifically the use of retirement bonds to replace payroll taxes in the financing of Social Security. In the proposals presented to the Commission, the use of retirement bonds--and annuities based on bond accumulations--would also replace the entire benefit structure of Social Security for the future.

In 1975, Charles Hobbs and Stephen Powlesland<sup>6/</sup> criticized the existing system as being inadequately funded, with benefits being politically determined, relying on a regressive tax, and resulting in a drastic reduction in private savings. The proposal which they

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<sup>6/</sup> Hobbs, Charles D. and Stephen L. Powlesland, Retirement Security Reform, Institute of Liberty and Community, 1975.

advanced to correct these defects "operates on the same basic premise as the present Social Security system; that it is in the public interest to compel people to provide for their retirement years". With health care treated separately (and not considered in this proposal), the plan would:

(1) End the payroll tax, passing on the savings through an across-the-board pay increase of an amount equal to the employer tax ;

(2) Require each employed person over age 25 to contribute, each year, either 10 percent of gross earned income or \$2,500, whichever is less, to a recognized individual or group pension program or to purchase an equivalent amount in U .S. Retirement Bonds. The value of the bonds would grow until maturity at an annual rate equal to the highest of three indicators: (a) the average interest rate on U.S. Treasury Bonds, (b) the growth rate of the Gross National Product, or (c) the growth rate of the Consumer Price Index;

(3) People could declare themselves retired at age 65 or older, at which point the bonds would be converted into a guaranteed annuity for life. At the death of the participant before retirement, a widow or widower and minor children would receive an adjusted annuity based upon the value of the bonds at the time of the participant's death until the death of the spouse or until the children reach

maturity.<sup>7/</sup> During retirement, the income of the annuity would be adjusted to grow at the rate of the highest of the three indicators for the remainder of the annuitant's life;

(4) A new and closely-regulated series of privately-managed and federally-insured pension plans would be set up under the authority of the Pension Benefit Guaranty Corporation (established by the Employee Retirement Income Security Act). Those holding U.S. Retirement Bonds could invest the proceeds, at any time prior to retirement, in any of these pension plans; the bonds invested would be redeemed by, and on schedules determined by, the Federal government. Except for inheritance, this would be the only condition under which the bonds could be transferred. The stated purpose is to "allow a bond holder to choose between a guaranteed basic retirement income and the possibility of a higher income realized through the private programs";

(5) Workers currently covered by Social Security would receive U.S. Retirement Bonds in an amount equal in retirement annuity value to what they could expect to receive under current Social Security law (there is no indication how this would be determined); current beneficiaries would receive an annuity equal to their present benefits-- both would be adjusted in the future by the highest growth rate of the three indicators;

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<sup>7/</sup> Presumably, for death after retirement, in order to provide an annuity for survivors, the individuals would be required to accept smaller annuities during their lifetime.

(6) The debt represented by the accrued liability of the present Social Security system would be covered by the proceeds from the sale of the U .S. Retirement Bonds and by increases in the personal income tax, as necessary.

Although a program of this type would not be an insurance program in which risks are pooled, the authors maintain that it would: ensure contributors a predictable benefit level at retirement; create an option for participants to invest in supervised individual retirement plans, thus expanding the range of individual choice; reduce the serious adverse impact of Social Security on private capital investment; and assign more equitably the financial burden that has already been incurred by the present system.

Essentially this proposal drops the insurance pooling elements and the weighted benefit formula of Social Security and substitutes a system of individual compulsory savings. Workers who are fortunate enough to work steadily throughout their lives could accumulate the savings to purchase a meaningful annuity, but those who had long periods of unemployment or who became disabled might find themselves at retirement with very inadequate savings. The spouse and children of a worker who died young would receive only the few bonds accumulated in a short period. The authors of the proposal believe that the private market "could amply supply" life insurance and disability insurance to take care of individual needs not met by the compulsory program. The authors suggest that survivor and disability benefits could be provided as an adjunct to the retirement bonds, but do not indicate precisely what would be provided, or how this adjunct would be administered and financed.

The Commission believes that a compulsory savings approach cannot provide the basic income security that is essential in our society. The risks and uncertainties of workers' earnings over their working careers are too great to justify total reliance on individual savings, whether voluntary or compulsory. The Social Security program provides basic protection whether the individual is fortunate or unfortunate, steadily attached to a job or forced to shift jobs as technology and economic opportunities change.

The Commission also has serious questions regarding the fiscal implications of such a retirement bond program. A very serious problem is the large increase in the size of the public debt which would result because the U.S. Retirement Bonds would be obligations of the Treasury. Sizeable amounts of general revenues would be needed to provide interest payments on the bonds (which could be quite high), as well as the continuing cost of indexing the annuity payments. In addition, the proposal calls explicitly for the use of general revenues to cover the accrued liabilities of the present system for those still working.

#### Transition Problems

Substitute proposals for the current Social Security system generally fail to indicate how the transition from the present program to the new one might be made. In general, a major obstacle to making a change from the present system to any totally new system is the difficulty of providing a workable and equitable transition. Decisions would have to be made about what benefits to pay current beneficiaries

and how both programs would be financed during the transition period. The Social Security program is financed on a pay-as-you-go basis and would need to be supported for several years. A new program would have to take over payments to its present beneficiaries and assume the accrued liabilities for those still working. These liabilities are currently estimated to be about \$5 trillion. The Commission believes that the transition financing problem is a significant barrier to the success of any substitute program.

#### Mandatory Private Pensions

Finally, it has been suggested that the Federal government should require employers to provide at least a minimum pension plan for their employees. Mandatory private pensions are proposed, not as an alternative to Social Security, but as a way to relieve the pressure on the Social Security program to provide more adequate retirement benefits. Those who advocate them point out that: (1) retirement incomes are often inadequate for retirees without private pensions; (2) under present conditions, private plan coverage is not expected to increase significantly; and (3) the mandatory pension contributions would provide funds for investment and capital formation .

If the Federal government were to mandate private pensions, it would also need to define the minimum provisions they must contain: which workers must be covered; what the minimum vesting requirements would be; the amount of the minimum contribution or benefit accrual rate; and the minimum provisions, if any, for indexing pensions

before or after retirement, for survivor benefits, or for past service credits. The Federal government would also be responsible for enforcing compliance with the law requiring employers to provide such pensions.

The National Commission does not believe that the Federal government should require employers to provide pensions. Workers not now covered by pensions tend to be lower-paid employees. Pension benefits would probably be financed through lower wages. Low-paid employees may be unwilling or unable to afford to forego part of their wages for pension contributions. Employers who do not provide pensions tend to be small businesses or less successful firms that are hard pressed to meet their current obligations. The added financial and administrative burden of mandatory pensions would be more than some could bear and still remain in business.

The Social Security program now covers about 9 out of 10 workers on a mandatory basis. It should continue to be the primary nationwide program for assuring workers a basic level of retirement income. The Commission believes it is neither necessary nor desirable for the Federal government to set up and enforce a second separate system to achieve similar goals.