The original documents are located in Box 54, folder "1975/12/02 - Economic Policy Board" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.

ECONOMIC POLICY BOARD MEETING
Tuesday, December 2, 1975
8:30 a.m.

Comparison of economic assumptions and automatic increases based on 1975 Trustees Report (TR) and OMB's August 15, 1975, assumptions, through calendar year 1981

alendar Year	Percent increase in -- average annual wages TR	OMB	average annual CPI TR	OMB	real wages TR	OMB	Percent unemployment rate TR	OMB	Contribution and benefit base [1] TR	OMB	Percent benefit increa TR	OMB
1975	6.2%	6.8%	9.0%	9.0%	-2.6%	-2.0%	8.8%	8.6%	$14,100	$14,100	8.0%	8.0%
1976	9.0	8.2	6.6	6.5	2.3	1.6	8.0	8.0	15,300	15,300	6.6	7.1
1977	11.0	7.9	6.5	5.2	4.2	2.5	7.0	7.5	16,800	16,500	6.4	5.2
1978	8.8	9.1	5.7	5.5	2.9	3.4	6.2	6.9	18,600	17,700	6.3	5.5
1979	7.7	9.1	4.6	4.8	3.0	4.1	5.4	6.2	20,100	19,200	4.8	5.1
1980	7.0	8.5	4.0	4.1	2.9	4.2	4.8	5.5	21,600	21,000	4.0	4.3
1981	6.0	8.5	4.0	4.0	1.9	4.3	4.8	4.7	23,100	22,800	4.0	4.0

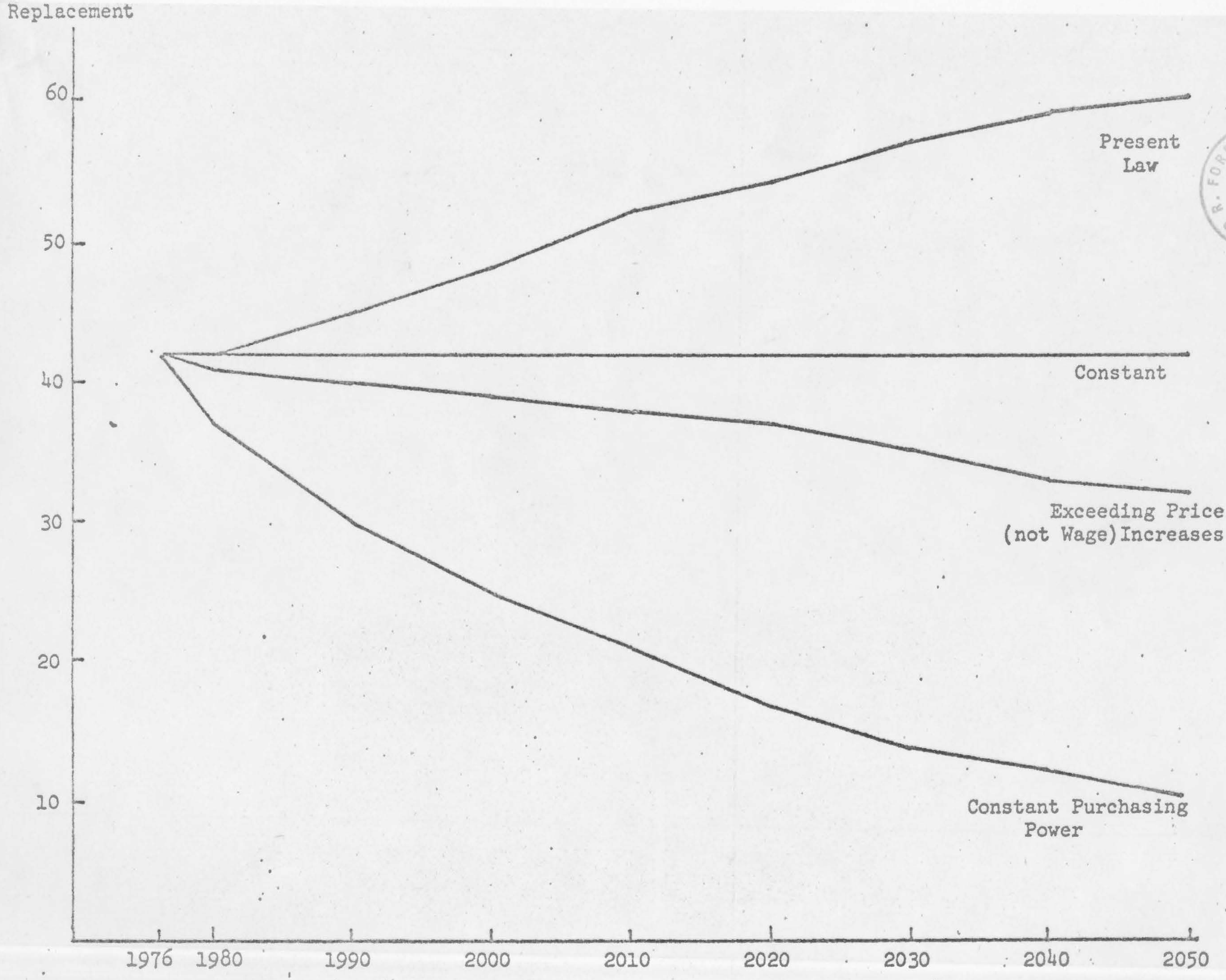
[1] Contribution and benefit bases for 1976 and later are higher than those published in the 1975 Trustees Report, and those first designated by OMB, because the recently determined 1976 base is $300 higher than the original estimate.

Office of the Actuary
November 24, 1975

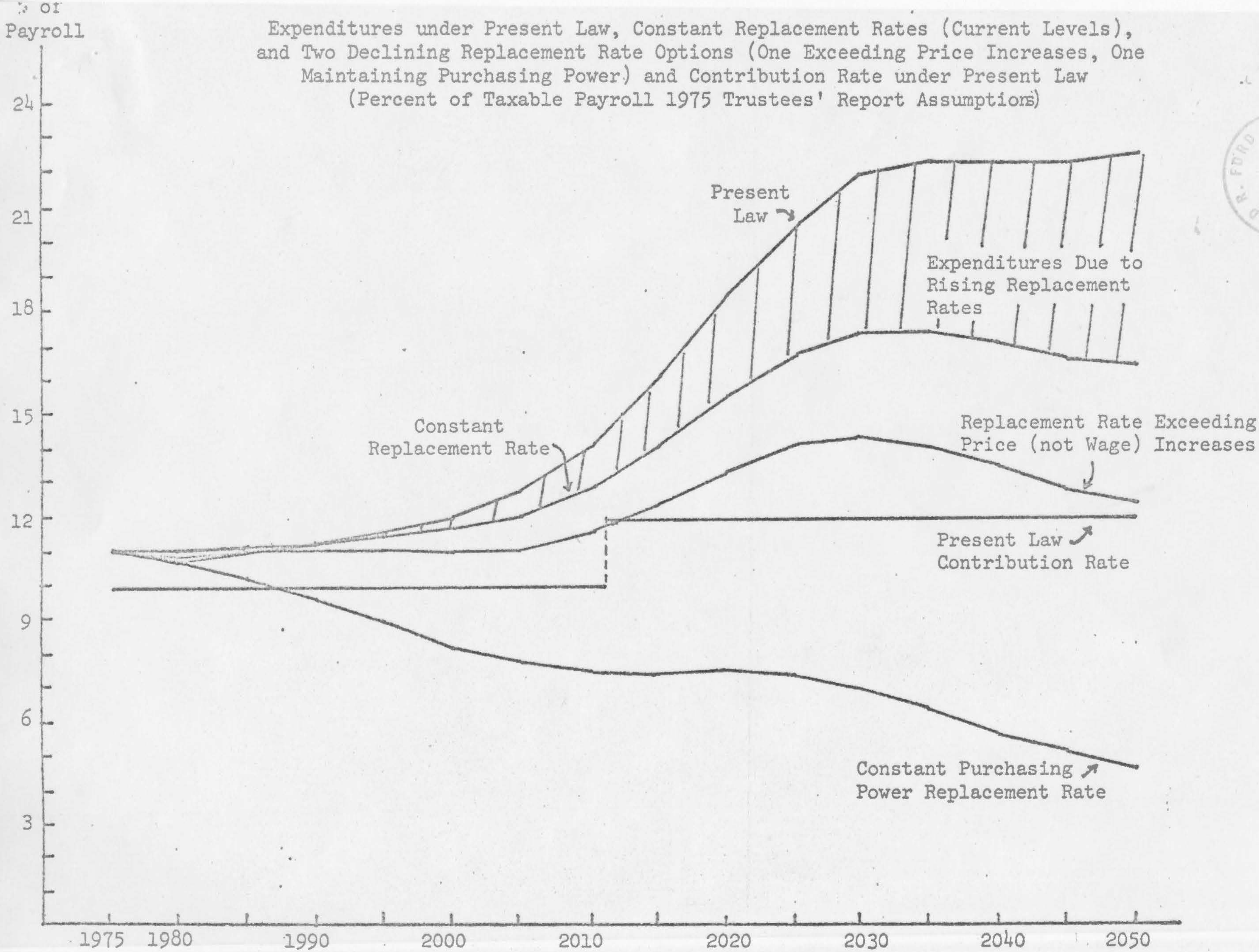
Estimated operations of the OASI and DI trust funds, combined, under present law -- comparison between estimates based on 1975 Trustees Report (TR) assumptions and OMB's August 15, 1975, assumptions, calendar years 1975-81 (In billions)

Calendar Year		Earnings base		Income		Outgo		Excess of income over outgo		Assets at end of year		Assets at beginning of year as a percentage of outgo during year	
		TR	OMB	TR	OMB	TR	OMB	TR	OMB	TR	OMB	TR	OMB
1975		#14,100	#14,100	#66.5	#66.5	#69.6	#69.6	#-3.0	#-3.0	#42.9	#42.9	66%	66%
1976		15,300	15,300	72.8	73.8	78.2	78.4	-5.4	-4.6	37.5	38.3	55	55
1977		16,800	16,500	82.3	81.4	87.4	87.3	-5.0	-5.9	32.4	32.4	43	44
1978		18,600	17,700	91.7	90.0	97.5	96.5	-5.8	-6.5	26.7	25.9	33	34
1979		20,100	19,200	100.9	99.9	107.1	105.8	-6.2	-5.9	20.5	20.0	25	24
1980		21,600	21,000	109.8	110.7	116.8	115.6	-7.0	-4.9	13.4	15.1	18	17
1981		23,100	22,800	117.6	122.8	126.6	125.4	-9.0	-2.6	4.5	12.5	11	12

Office of the Actuary
November 24, 1975


Replacement
60
50
40
30
20
10
1976
1980
1990
2000
2010
2020
2030
2040
2050
Present Law
Constant
Exceeding Price (not Wage) Increases
Constant Purchasing Power

Expenditures under Present Law, Constant Replacement Rates (Current Levels), and Two Declining Replacement Rate Options (One Exceeding Price Increases, One Maintaining Purchasing Power) and Contribution Rate under Present Law (Percent of Taxable Payroll 1975 Trustees' Report Assumptions)



Long-Range Cost Estimates and Replacement Rates under Present Law and under Decoupling Alternatives Based on Wage Indexing 1/

Long-Range Costs

Present Law	Average 2/ 75 Years (1975-2049)	First 25 Years (1975-1999)	Second 25 Years (2000-2024)	Third 25 Years (2025-2049)
Expenditures	16.26%	11.16%	15.12%	22.09%
Taxes	10.94	9.90	11.02	11.90
Difference	-5.32	-1.26	-4.10	-10.19
Decoupling Models				
Constant Replacement Rates 3/	13.80	11.12	13.35	16.66
Replacement Rate Exceeding Price, not Wage, Increases (Slow Decline) 4/	12.13	10.81	11.96	13.39
Replacement Rate Limited to Increases in Purchasing Power (Fast Decline) 5/	7.6	9.77	7.41	5.85

Replacement Rates

	1976	2000	2025	2050
Low Earner 6/				
Present Law	62%	75%	96%	107%
Constant	61	61	61	61
Slow Decline	61	55	49	45
Fast Decline	61	37	23	14
Average Earner 6/				
Present Law	42	58	56	60
Constant	42	42	42	42
Slow Decline	42	39	36	32
Fast Decline	42	25	16	10
Maximum Earner 6/				
Present Law	30	36	41	43
Constant	30	34	35	35
Slow Decline	30	30	27	25
Fast Decline	30	18	11	7

See footnotes on following page.

Footnotes

1/ Refers to a system of updating a worker's earnings to take account of changes in average earnings in the economy.

2/ Includes the cost of building the trust funds to 100 percent of annual expenditures.

3/ Under the basic wage-indexing model the computation period would lengthen each year until it ultimately reached 35 years, as under present law. A worker's actual earnings would be indexed in relation to average earnings in the economy so that they are updated to the period immediately preceding the period in which the worker retired, became disabled, or died. A weighted benefit formula (adjusted by the annual percentage rate of increase in average covered wages) would be used to determine initial benefits, and an individual's benefits would be adjusted for increases in the cost of living after entitlement. Produces replacement rates (the PIA as a percentage of earnings in the year before retirement) that are constant over time.

4/ Same as the basic model except that the benefit formula would be adjusted by the percentage increase in first-quarter average covered wages minus 1 percent. Produces replacement rates that decrease slowly over time.

5/ Same as the basic model except that the factors in the benefit formula would be adjusted by the inverse of the rate of increase in real wages. Produces replacement rates that decrease rapidly over time.

6/ The 1975 earnings levels of $3400 for low earners, $8500 for average earners, and $14,100 for maximum earners are adjusted annually according to the central earnings assumptions used in the 1975 OASDI Trustee's report.

Table A

Present Law and Rate-Increase-Only Options
(Amounts in Billions)

Calendar Year	Present Law: OASDI	Present Law: HI	Present Law: Total	Option A-1: OASDI	Option A-1: Total 1/	Option A-2: OASDI	Option A-2: Total 1/	Option A-3: OASDI	Option A-3: Total 1/	Option A-4: OASDI	Option A-4: Total 1/
1977	4.95%	0.90%	5.85%	5.30%	6.20%	5.30%	6.20%	5.25%	6.15%	5.25%	6.15
1978	4.95	1.10	6.05	5.40	6.50	5.40	6.50	5.35	6.45	5.35	6.45
1979	4.95	1.10	6.05	5.40	6.50	5.40	6.50	5.35	6.45	5.35	6.45
1980	4.95	1.10	6.05	5.40	6.50	5.40	6.50	5.35	6.45	5.35	6.45
1981	4.95	1.35	6.30	5.50	6.85	5.45	6.80	5.50	6.85	5.45	6.80
1982	4.95	1.35	6.30	5.50	6.85	5.45	6.80	5.50	6.85	5.45	6.80
1983	4.95	1.35	6.30	5.50	6.85	5.55	6.90	5.50	6.85	5.55	6.90
1984	4.95	1.35	6.30	5.50	6.85	5.55	6.90	5.50	6.85	5.55	6.90
1985	4.95	1.35	6.30	5.50	6.85	5.55	6.90	5.50	6.85	5.55	6.90

Calendar Year	Present Law: OASDI Assets End of Year	Present Law: OASDI Assets Beginning of Year as % of Outgo	Option A-1: OASDI Assets End of Year	Option A-1: OASDI Assets Beginning of Year as % of Outgo	Option A-2: OASDI Assets End of Year	Option A-2: OASDI Assets Beginning of Year as % of Outgo	Option A-3: OASDI Assets End of Year	Option A-3: OASDI Assets Beginning of Year as % of Outgo	Option A-4: OASDI Assets End of Year	Option A-4: OASDI Assets Beginning of Year as % of Outgo
1977	$32.4	43%	$37.8	43%	$37.8	43%	$37.0	43%	$37.0	43%
1978	26.7	33	40.4	39	40.4	39	38.7	38	38.7	38
1979	20.5	25	44.2	38	44.2	38	41.3	36	41.3	36
1980	13.4	18	48.6	38	48.6	38	44.5	35	44.5	35
1981	4.5	11	55.0	38	53.8	38	50.5	35	49.4	35
1982	- 7.0	3	60.9	40	58.5	39	56.2	37	53.7	36
1983	-21.5	2/	66.0	41	64.6	40	61.0	38	57.0	36
1984	-40.0	2/	69.5	41	69.5	40	64.2	38	61.2	36
1985	-63.4	2/	70.7	40	72.2	40	65.0	37	63.4	35

1/ Includes same HI rate as in present law.

2/ Combined OASDI funds are exhausted in 1982.

Table B

Present Law and Ba[illegible]ate Increase Options

	Present Law					Option B1		Option B2		Option B3	
Calendar Year	Base	OASDI	HI	Total	Base for all "B" Options	OASDI	Total1/	OASDI	Total1/	OASDI	Total1/
1977	$16,800	4.95%	0.90%	5.85%	$19,500	4.95%	5.85%	4.95%	5.85%	4.95%	5.85%
1978	18,600	4.95	1.10	6.05	21,600	5.25	6.35	5.25	6.35	5.20	6.30
1979	20,100	4.95	1.10	6.05	23,400	5.25	6.35	5.25	6.35	5.20	6.30
1980	21,600	4.95	1.10	6.05	25,200	5.25	6.35	5.25	6.35	5.20	6.30
1981	23,100	4.95	1.35	6.30	27,000	5.35	6.70	5.30	6.65	5.25	6.60
1982	24,600	4.95	1.35	6.30	28,500	5.35	6.70	5.30	6.65	5.25	6.60
1983	26,100	4.95	1.35	6.30	30,300	5.35	6.70	5.40	6.75	5.25	6.60
1984	27,600	4.95	1.35	6.30	32,100	5.35	6.70	5.40	6.75	5.40	6.75
1985	29,400	4.95	1.35	6.30	33,900	5.35	6.70	5.40	6.75	5.40	6.75

	Present Law		Option B1		Option B2		Option B3	
	OASDI Assets End of Year (billions)	OASDI Assets Beginning of Year as % of Outgo	OASDI Assets End of Year (billions)	OASDI Assets Beginning of Year as % of Outgo	OASDI Assets End of Year (billions)	OASDI Assets Beginning of Year as % of Outgo	OASDI Assets End of Year (billions)	OASDI Assets Beginning of Year as % of Outgo
1977	$32.4	43%	$34.9	43%	$34.9	43%	$34.9	43%
1978	26.7	33	37.9	36	37.9	36	37.0	36
1979	26.5	25	42.4	35	42.4	35	40.4	35
1980	13.4	18	47.7	36	47.7	36	44.5	35
1981	4.5	11	55.0	38	53.9	38	49.2	35
1982	- 7.0	3	61.8	40	59.3	39	53.0	36
1983	-21.5	(2/)	67.7	42	63.6	40	55.5	36
1984	-40.0	(2/)	72.2	42	69.2	40	60.5	35
1985	-63.4	(2/)	74.2	42	72.5	40	63.3	35

1/ Includes same HI rate as in present law.

2/ Combined OASDI funds are exhausted in 1982.

Table C

Operations of the OASDI Trust Funds Under Present Law and
Under the Program Modified by Eliminating the June 1976 Automatic Benefit Increase
(Amounts in Billions)

Calendar Year	Excess of Income Over Outgo: Present Law	Excess of Income Over Outgo: Benefit Increase Elimination	Excess of Income Over Outgo: Savings of Option Over Present Law	Assets End of Year: Present Law	Assets End of Year: Benefit Increase Elimination	Assets Beginning of Year as % of Outgo: Present Law	Assets Beginning of Year as % of Outgo: Benefit Increase Elimination
1976	$- 5.4	$ -2.9	$ 2.5	$ 37.5	$ 40.0	55%	57%
1977	- 5.0	0.7	5.7	32.4	40.7	43	49
1978	- 5.8	1.1	6.9	26.7	41.8	33	45
1979	- 6.2	1.8	8.0	20.5	43.6	25	42
1980	- 7.0	2.1	9.1	13.4	45.7	18	40
1981	- 9.0	1.4	10.4	4.5	47.1	11	39
1982	-11.4	0.3	11.7	- 7.0	47.3	3	37
1983	-14.5	-1.3	13.2	-21.5	46.0	1/	34
1984	-18.5	-3.6	14.9	-40.0	42.3	1/	31
1985	-23.4	-6.7	16.7	-63.4	35.6	1/	26

1/ Combined OASDI funds exhausted in 1982.

THE WHITE HOUSE

WASHINGTON

November 29, 1975

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

FROM: L. WILLIAM SEIDMAN

SUBJECT: Special Session on Railroads

The attached memorandum from Secretary Coleman on "The Long-Term Role of the United States Railway Association" will be discussed at a special session of the EPB Executive Committee on Tuesday, December 2, 1975, at 4:30 p.m. in Room 208 EOB.

Attachment

THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

November 28, 1975

MEMORANDUM FOR THE ECONOMIC POLICY BOARD

Subject: The Long-Term Role of the United States Railway Association

You have asked for a position paper regarding the appropriate long-term role of the United States Railway Association ("USRA"). The basic issue is whether it is in the public interest to set in place an independent government agency with authority to make legislative recommendations calling for massive expenditures of Federal money when such agency is not subject to the normal Executive Branch budgetary process.

This issue is raised in the context of the curent status of the omnibus railroad legislation in the Congress which seeks to assign various new functions to USRA.

Although several public members of the USRA Board of Directors have expressed themselves as opposed to an expanded planning or financing function for USRA, the Board did not vote on the question, largely because Arthur Lewis, Chairman of USRA, argued that it would not be appropriate for USRA to be telling Congress what it should do. Nevertheless there appears to be some effort on the part of some USRA officials to encourage legislative efforts to expand USRA's functions.

Background

The Regional Rail Reorganization Act of 1973 ("the Act") established USRA and authorized it to carry out three tasks: (1) engage in the preparation and implementation of the Final System Plan ("FSP"); (2) issue obligations under section 210 and to make loans to ConRail, Amtrak, and other railroads under section 211 of the Act; and (3) provide loans or loan guarantees to state, local or regional transportation authorities under section 403 of the Act to acquire and modernize rail lines.

As part of the implementation of the FSP, it was envisioned that USRA would be the principal defender of its plan in all court proceedings with respect to the Plan. In addition, it would be the major, if not the exclusive, source for funding ConRail by guaranteeing loans of up to $1 billion. USRA was also authorized to make loans to Amtrak and other solvent railroads in the region for purposes of assisting in the implementation of the FSP, and to make loans to railroads connecting with bankrupt railroads in the region to enable the connecting railroads to avoid reorganization proceedings. Also, so long as 50 percent of ConRail's debt was owed to or guaranteed by the government, the chairman and president of USRA (and the Secretary of Transportation) were to serve as members of ConRail's Board.

Actually, USRA never came up with a plan which was within the parameters of the 1973 Act. Instead the plan required a greater commitment of Federal funds.

The FSP issued by USRA drastically changed USRA's role in several key respects. First, the loan guarantee of only $1 billion was dropped. Instead the amount and form of funding for ConRail was changed to provide up to $2.1 billion of assistance by way of direct loans and equity investment to ConRail from funds appropriated directly to USRA. This assistance was to be invested over a five-year term during which ConRail's performance would be monitored by a committee of the USRA Board composed of its chairman and the Secretaries of Transportation and the Treasury (the "Government Investment Committee"). This committee would be vested with certain powers concerning the establishment of terms and conditions for the purchase of ConRail's securities and for making determinations from time to time that would enable that committee to stop further funding of ConRail or provide such funding only upon new terms and conditions. Moreover, that committee had the power to forgive payment by ConRail of interest and principal on those securities. These powers were vested in a committee, the majority of which would be Administration representatives, rather than in USRA, because of the overwhelming government interest in the investment and the need to assure protection of that investment in the best interests of the government as represented by persons subject to the direct control of the President.

Second, the FSP recommended that a procedure be established to carry out supplementary transactions within six years after the conveyance of properties to ConRail. These transactions would involve the transfer of all or part of ConRail's properties to other carriers and entities with the general (but unstated) objective that such transfers would better serve the public interest by improving the national or regional structure of the rail system or by lowering the long-term cost to the government of the reorganization process. In this new function USRA would be given the role of reviewing proposals for such transfers submitted by the Secretary of Transportation and determining whether the proposals are fair and equitable and in the public interest. The proposals would ultimately be reviewed by the special court, and USRA's determinations in this regard would not foreclose submission of the Secretary's proposals directly to the special court or be binding in any way upon the ultimate determination of that court.

Third, because of the conflict presented by the role of the USRA chairman on the Government Investment Committee, only the president of USRA would serve on the ConRail Board for the entire period that the government's investment in ConRail remains outstanding. (The Secretary of Transportation would also be dropped from the ConRail Board.)

The Department separately proposed on behalf of the Administration that USRA's role, as envisioned by the Act and by the amendments to implement the FSP, be changed in two respects:

(1) USRA's authority to make loans would be limited solely to loans to ConRail since funding by USRA for all other purposes existing under the Act was no longer necessary; and

(2) the authority to make loans to states or local or regional transportation authorities under

section 403 would be given to the Secretary of Transportation, who is otherwise responsible for subsidizing light density lines under Title IV.

(It should be noted that, with respect to the latter change, USRA advised us unofficially that they did not have any objections, but we don't know what they have been saying to the Congress.)

Omnibus Legislation

The role of USRA in implementing the FSP and in other nationwide aspects of rail planning and assistance has now been greatly expanded in the bill reported by the Senate Commerce Committee. The following summarizes those changes:

(1) Oversight of ConRail. The Senate bill eliminates the role of the Government Investment Committee and vests in USRA the power to establish all terms and conditions with respect to the purchase of ConRail's obligations as well as the power to make any determination regarding ConRail's achievement of its goals and the power to forgive payment of principal and interest on ConRail's securities.

(2) Supplementary Transactions. USRA is given the power to block the presentation to the special court by the Secretary of proposals for supplementary transactions.

(3) Railroad Rehabilitation Funding. The Senate bill establishes a "trust fund" under the direction and control of USRA for the purpose of (a) funding ConRail by the purchase of its securities as contemplated in the FSP and (b) providing assistance to other carriers for working capital and rehabilitation purposes. USRA is also given the power to make certain determinations and recommendations with respect to the need for equity financing by the carriers and the most appropriate means of providing such financing. The source of funds for the "trust fund" is, however, merely appropriations out of the general treasury to USRA.

(4) Northeast Corridor. The Senate bill authorizes USRA to provide the financing for the implementation of the Northeast Corridor Improvement project by making

available non-interest-bearing loans to Amtrak for the use of the Northeast Corridor Improvement Corporation to be established pursuant to the bill for upgrading of the Corridor or to other railroads or to state or local or regional transportation authorities responsible for service in the Corridor. The amount for the Corridor is set forth as $3.8 billion rather than the $1.08 billion the Administration wants.

(5) Assistance Under Title IV. Neither the House nor the Senate bill adopts the Administration's position with respect to removing the Association's existing role under Title IV for acquisition and modernization loans.

(6) Loans to Other Railroads. The Senate bill makes no change in USRA's existing authority to make loans to "connecting" railroads or solvent railroads in the region, and leaves the total authorization at $500 million rather than the $25 million we requested.

(7) The salary for the Chairman of USRA has been raised from $60,000 to $85,000.

Even though each of the changes is contrary to what the Administration and USRA agreed upon, USRA has not resisted the changes, and, indeed, has at least tacitly helped to bring them about.

Administration Position

This Board should recommend to the President that the Association's role be limited solely to (a) providing assistance to ConRail with the controls provided by the Government Investment Committee and (b) reviewing supplementary transactions as proposed in the Final System Plan. This would circumscribe USRA's role to that of simply implementing certain appropriate aspects of the Final System Plan. The major part of that role would be completed within six years after the startup of ConRail. Subsequently, assuming its role in litigation has terminated, the Association's role would be comparable to that of a passive trustee in a normal private market financing and it would continue to have its president serve on the Board of ConRail. The Association should not undertake any future planning or financing role; rather, those functions should be placed exclusively in the Department of Transportation. (This is the role assigned the Department in the Administration's Railroad Revitalization Act of 1975, which gives the Secretary authority to make and guarantee flexible loans to all railroads.) Only in this way can rail transportation policy receive the central policy guidance and budget control essential to effective but limited government involvement in the rail industry.

Even more important is the question of whether USRA should be permitted to make legislative and budgetary recommendations without first going through the normal process that the Department of Transportation has to go through. For example, the Department developed a recommendation for the Northeast Corridor and after going through the budgetary process the President decided that the program should be one which does not exceed \$1.08 billion in Federal funds. The Department of Transportation also went through the Economic Policy Board and the Office of Management and Budget in connection with the recommendation that the government investment in ConRail should be put at \$2.1 billion. Now we find USRA not resisting a Senate bill which calls for \$3 billion. In other words, I don't think it is in the public interest to have an agency of government which can make recommendations to Congress without regard to the costs thereof or the overall budgetary effect and whether such effect is consistent with the President's overall budgetary decisions.

Other reasons why I feel that the role of USRA should not be expanded include:

(1) Since USRA created ConRail there might develop a relationship where USRA would be more lenient in holding ConRail to agreements than would be the case if ConRail had to deal with an agency that had not the same part in creating ConRail.

(2) The "blue ribbon" board of USRA and its staff, assembled to meet the emergency in the Northeast, would not stay over a long period of time. In fact, some of the staff have already left and indeed some are looking for jobs with ConRail.

(3) Expanding the role of USRA would merely add another bureaucracy to consider general questions of

surface transportation policy (which bureaucracy, like all others, would soon get a permanent life).

Thus, my recommendations are as follows:

(1) That USRA's role be limited solely to seeing through the setting up of ConRail and the investment which the government is to make in ConRail up to $2.1 billion with the supervision of the Government Investment Committee.

(2) That the staff and budget of USRA be reduced. At the height of its work with the FSP, USRA employed 311 people and spent $40 million over an eighteen month period. In its appropriate new role, it certainly would not need a budget in the same amount and there is no justification for the same number of personnel.

Bill

William T. Coleman, Jr.

November 29, 1975

ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

Proposed Agenda - Revised

Monday, December 1, 1975

1.	Report on Coffee Agreement Negotiations	State
2.	Food Deputies Report	MacAvoy
3.	U.S. Grain Export Policy Statement	
4.	Assumptions for the 1977 Budget's Economic Forecast	Troika 2

Tuesday, December 2, 1975

1.	Social Security Reform	Domestic Council
	Special Session on Railroad Legislation [4:30 p.m., Room 208 EOB]	

Wednesday, December 3, 1975

1.	Tax Exempt Financing for Regional Municipal Power Systems	Treasury
2.	Public Debt Limitation	Treasury
3.	Report of Task Force on Taxation of International Investment	Jones

Thursday, December 4, 1975

1.	Broadening Employee Stock Ownership	Seidman
2.	Status Report on Tax Reduction and Spending Restraint Initiative	

Friday, December 5, 1975

No Executive Committee Meeting

THE WHITE HOUSE

WASHINGTON

November 29, 1975

MEMORANDUM FOR ECONOMIC POLICY BOARD
EXECUTIVE COMMITTEE

FROM: L. WILLIAM SEIDMAN

SUBJECT: Social Security Financing

The attached draft memorandum on Social Security Financing, prepared by the Domestic Council, will be considered at the Tuesday, December 2, Executive Committee meeting.

Attachment

DRAFT

THE WHITE HOUSE

WASHINGTON

November 28, 1975

MEMORANDUM FOR:

FROM:

SUBJECT: Social Security Financing

The purpose of this memorandum is to present for your decision options for dealing with the serious short and long term financing problems facing the Social Security System. The timing of any legislative proposal is clearly a key element in your decision. Therefore, the discussion of options will include a projection of the effect on the stability of the trust fund and an assessment of political and budgetary consequences.

CURRENT SYSTEM:

In 1974, the Social Security System collected $58.70 billion for OASDI from 99 million workers in covered employment and paid $58.5 billion in OASDI benefits to 31 million beneficiaries. The current OASDI tax rate is 9.9% (4.95% each paid by employers and employees) on a minimum wage base of $14,100. The wage base will increase to $15,300 in calendar year 1976. The current tax rate for the HI (medicare) trust fund is 1.8% (.9% each paid by employers and employees). An increase is scheduled in 1978.

Social Security Tax Rates:

	Present Law		
Calendar Year	OASDI	HI	TOTAL
1977	4.95%	0.90%	5.85%
1978	4.95	1.10	6.05
1979	4.95	1.10	6.05
1980	4.95	1.10	6.05
1981	4.95	1.35	6.30
1982	4.95	1.35	6.30
1983	4.95	1.35	6.30
1984	4.95	1.35	6.30
1985	4.95	1.35	6.30

PROBLEMS

The OASDI trust fund is underfinanced in the short and long term. Benefit outlays are expected to exceed payroll tax receipts in 1975 and every year thereafter. Under current law, the projected deficit will average 1.3% of taxable earnings over the next 25 years (1975 - 1999) and will rise to 4.1% in the following 25-year period (2000 - 2024).

Unless some action is taken, OASDI trust funds will fall from the current 66% of yearly outgo to 43% in 1977, 33% in 1978; 11%in 1981, 3% in 1982, and the trust funds will be exhausted in 1983. The projected rapid decline in trust funds assets over the next few years can be attributed to:

- Increased benefits resulting from wage growth and inflation.

- Absence of equivalent increases in payroll tax revenues. (In fact payroll tax receipts have diminished due to high rates of unemployment.)

The projected long term (beyond 2000) deficits can be attributed to:

- Future population trends which include a substantially increasing ratio of retired persons to the working population after the beginning of the 21st Century.

- A flaw in the current system which over adjusts the benefits of future retirees to inflation. The current formula which determines future benefits for workers increases the weighting of earnings by the rate of inflation. Since wages normally grow with inflation, the result is an overcompensation - commonly referred to as a "coupled" system. There is a general consensus in the Congress and among outside experts that the inflation adjustment in the formula should be eliminated, thus "decoupling" the system. Such a change would not affect the automatic CPI increases in benefits after retirement. It should be emphasized here that "decoupling" will have virtually no effect on the short term deficit.

POLITICAL CONTEXT:

An awareness of the political environment surrounding the Social Security System is crucial as we sort out these very important issues. Decisions regarding social security have traditionally followed a unique pattern which has insulated the system from sudden and far reaching changes. Structural modifications take place usually after extensive public debate including exhaustive studies and visible commissions. Protection of the system is fostered by one of the strongest and largest constituencies in the public policy arena, including the elderly, organized labor and all of the wage earners who are contributing to the system and expect to benefit from it in the future.

Members of Congress and especially of the Finance and Ways and Means Committees have institutionalized this process of incremental reform. The Committees have jointly established a high level advisory working group to examine the "decoupling" problem and to recommend policy changes to the Committees in the spring of 1976.

Because of the serious financing problems the Social Security System now faces, the public has begun to question its stability. Although the subtleties and complexities are not widely understood, there exists some general pressure to move toward stabilizing the trust fund with a minimum of disruption and change for those in the system.

DECISIONS:

Alternatives for your decisions are presented in three categories:

1. Options to deal with the short term decline in trust fund assets.

2. "Decoupling" options which alleviate the long term deficit.

3. Mechanisms for analyzing some of the broader structural issues in the Social Security System.

These sets of options including choices of the timing of any initiative you choose are described as follows.

SHORT TERM FINANCING:

The choices for preventing the rapid decline of the trust fund are difficult ones. Simply expressed, revenues must be increased or benefits must be reduced. Your decision and the timing of any action should take into account the effect on the trust fund, budgetary and political consequences.

Estimated Trust Fund Assets under Current Law:

Calendar Year	Assets at Beginning of Year as Percent of Outgo during Year
1975	66%
1976	55%
1977	43%
1978	33%

Calendar Year	Assets at Beginning of Year as Percent of Outgo during Year
1979	25%
1980	18%
1981	11%
1982	3%
1983	0%

These projections by the Social Security Administration are based on economic assumptions which are regarded by many as optimistic. HEW has taken the position that it would be dangerous for the trust fund assets to fall below 33%. In order to prevent the trust fund from falling below 33% in 1978, legislation to increase revenues or to decrease benefits must be enacted before January 1, 1978. If you agree that SSA's economic assumptions are optimistic and/or that the trust fund should not fall so low, then more immediate action is required during FY 1977 or FY 1978.

Short term financing options which prevent the trust fund assets from falling below one-third include:

1. Increase Revenues by Raising Payroll Taxes.

It would be necessary to increase ~~tes~~ taxes by .6% of payroll beginning in 1977 or 1978 and to gradually increase that amount to 1.1% or 1.2% by 1983.

Given your proposal for a permanent tax reduction, it would be very difficult to propose and justify an increase in payroll taxes in the next year or so. An increase in the payroll tax has a particularly harsh effect on low income wage earners. ON the other hand, such an increase would eliminate the trust fund deficit until 2000.

2. Increase revenues by a combination of a more modest increase in taxes and raising the wage base to which they apply.

If the wage base were raised from the currently projected $16,800 for 1977 to $19,500, the necessary tax increase would be .3% of payroll beginning in 1977 or 1978 and approximately .9% by 1983.

Again, even a more modest increase in taxes would be difficult, given economic and political considerations. Even though a tax/wage base increase would eliminate the trust fund deficit until 2000, high wage earners would assume more of the tax burden and would be entitled to higher future benefits, thereby enlarging the trust fund deficit after 2000.

3. Reduce outlays by placing a cap on the July, 1976 CPI increase and decreasing certain other benefits.

OMB has proposed increasing benefits by only 60% of the 1976 CPI and several program changes including:

a) Do not pay retroactive benefits for the months before an application is filed if such a lump-sum payment would require a permanent actuarial reduction in future monthly benefits.

b) Eliminate the monthly retirement test, making the retirement rest on cumulative annual earnings.

c) Eliminate over a 4-year period special benefits for those aged 18 to 22 in school full-time.

The 60% cap on CPI would save $2.24 billion in 1978 and an increasing amount in subsequent years. The other program changes would save approximately $1 billion in 1977 and __________ in subsequent years. Such reduced expenditures would keep the trust fund levels about one-third of outgo until 1980. It would again be necessary to reduce expenditures further or to provide some additional income.

This proposal to reduce benefits would be more consistent with our economic policy than any tax increase, but it may be difficult politically to propose reducing benefits for the elderly and disabled. It eliminates only a portion of the deficit until 2000. At best it postpones another decision on short term financing for about 4 years.

RECOMMENDATIONS:

DECISION

Take action in FY 1977
Option 1: ___________
Option 2: ___________
Option 3: ___________

Defer action until:
FY 1978___________
FY 1979___________

DECOUPLING:

Decoupling is a long term financing issue, as the coupled system (which went into effect in 1975) will not impact on the deficit until after 2000.

There exists a general consensus in Congress and among outside experts that the overadjustment for inflation should be changed, thus "decoupling" the system. There is, unfortunately, no clear consensus about how the formula should be changed.

The major issue, on which there may be wide disagreement, is a philosophical question about what should be the future role of social security. What levels of tax rates and benefits would be appropriate in the context of overall taxes and retirement income.

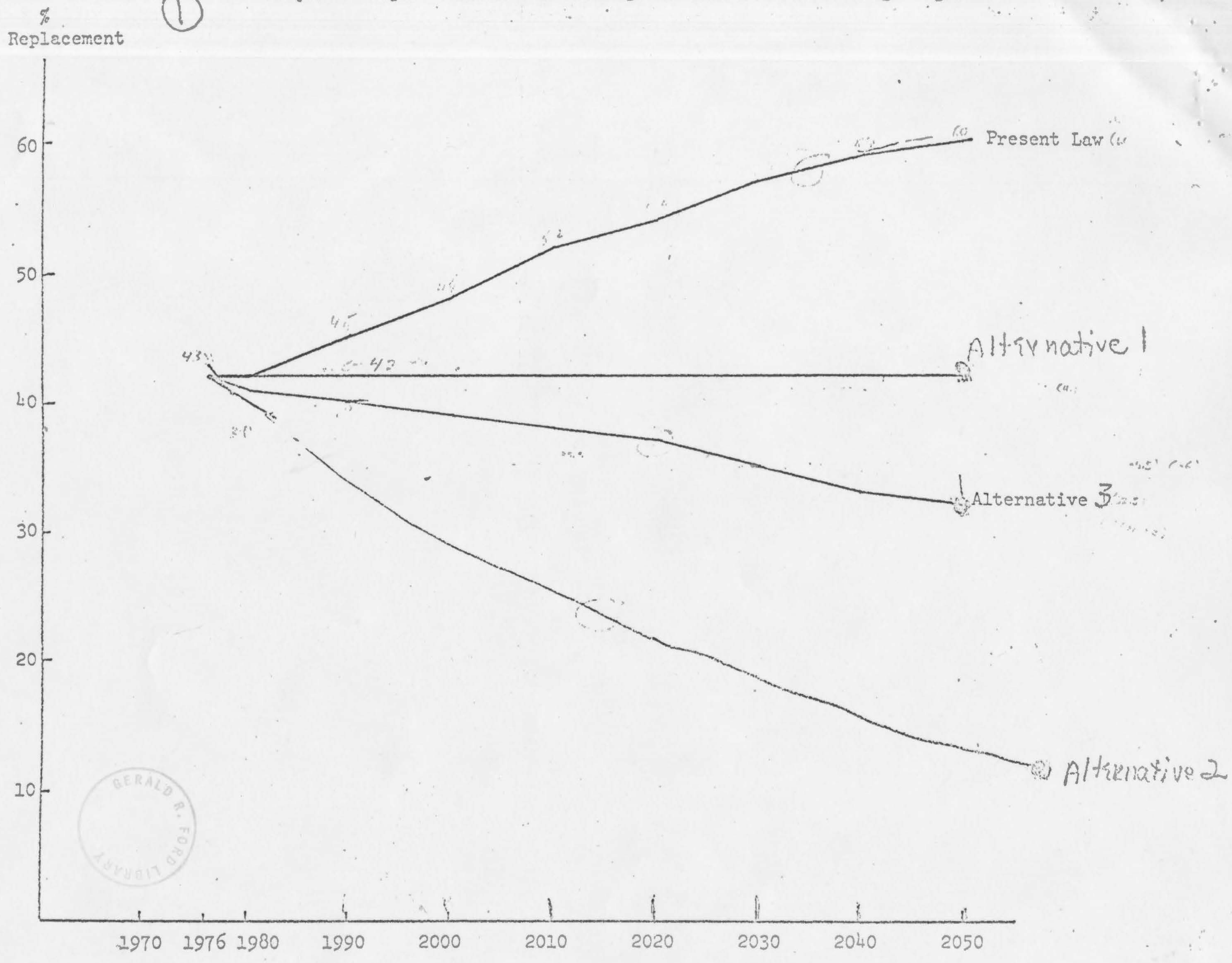
In considering alternative "decoupling" models, this philosophical question translates into a choice between continuing to provide benefits at the same percentage of wages as the current system vs. allowing replacement rates to decline over time.

A word of explanation about the concept of "replacement rates" -- The current benefit formula provides various replacement rates (benefit amounts as a percentage of wages) for various wage groups. At the time of retirement, the wages of a Social Security beneficiary are replaced at a given percentage of his wages (replacement rate). After retirement this benefit level rises automatically with increases in the CPI. In the current coupled system, replacement rates for every category of wage earner are rising over time due to the double indexing of the benefit base. This is clearly undesirable and should be corrected.

The question is whether replacement rates should remain constant or decline over time. If replacement rates are to remain constant, at what level should they be fixed or if they are to decline, at what rate should they be allowed to decline. The benefit formula can be adjusted to produce the desired constant or declining replacement rates.

The following graphs illustrates the effect on benefit levels (replacement rates) and expenditures under three alternative decoupling models as compared to the current law "coupled" system.

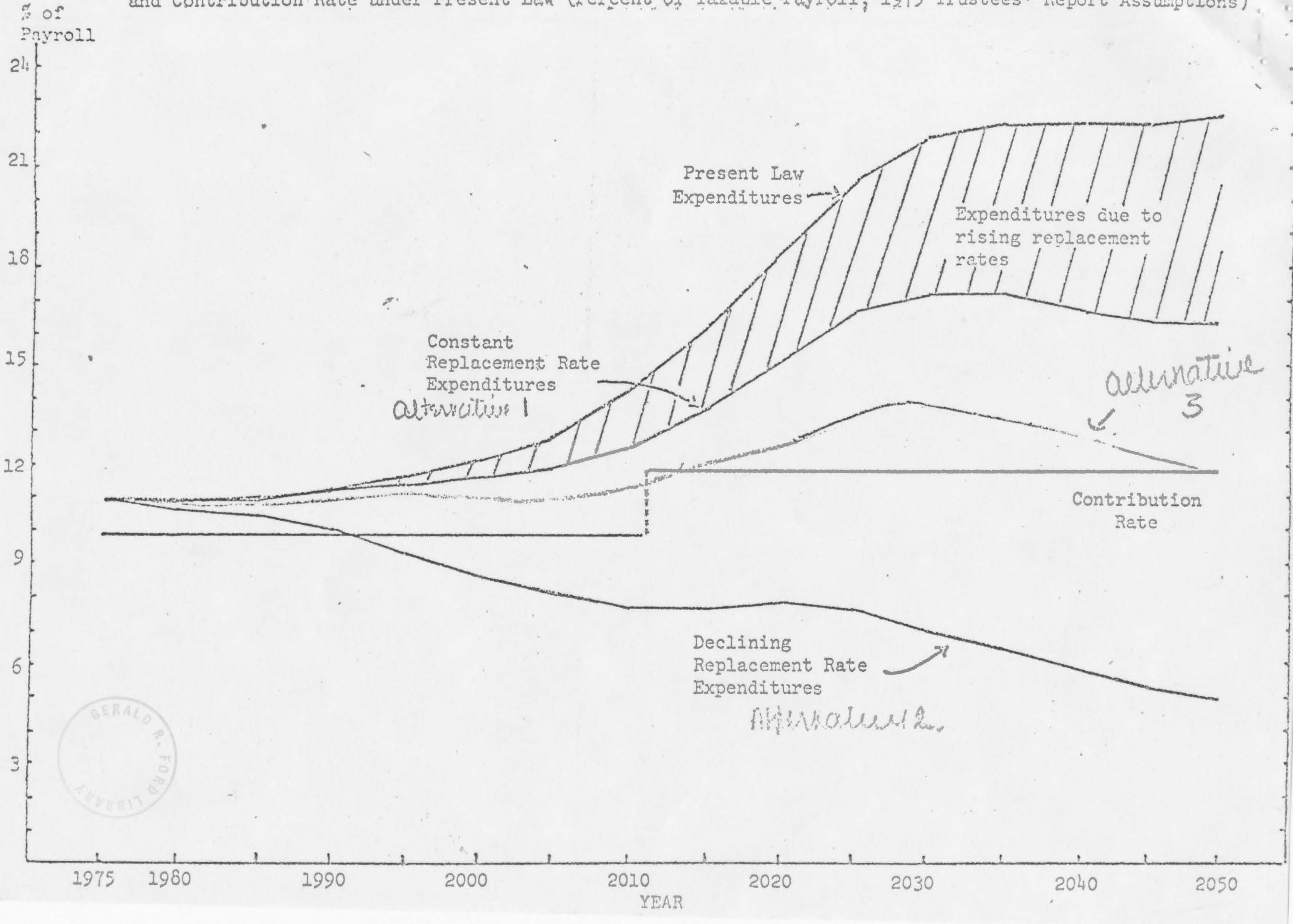
Projected Replacement Rates for Regular Workers with Average Wages



(7)

Expenditures

Expenditures under Present Law, Constant Replacement Rates (Current Levels), and Declining Replacement Rates (Maintenance of Purchasing Power) and Contribution Rate under Present Law (Percent of Taxable Payroll, 1975 Trustees' Report Assumptions)



Rising replacement rates under the current system are clearly unacceptable. The alternative choices are described, as follows:

1. Alternative 1 - simply holds constant current replacement rates. It eliminates approximately 50% of the long term deficit. Therefore additional tax revenues would be required eventually. Because this proposal decouples with a minimum of change in future benefits, it would probably prove the least controversial among constitutent groups and in Congress.

2. Alternative 2 - allows benefit levels for future retirees to keep pace with inflation instead of real wage growth. This means that if such a proposal were enacted in 1976, the level of future benefits of workers would maintain a portion of their purchasing power in 1976 rather than keeping up with higher standards of living resulting from real wage growth. Replacement rates would decline substantially over time, as illustrated in graph #1, thus reducing the future role of social security. This proposal would eliminate the entire long term deficit and would allow future tax reductions. Such a far reaching change in the system would probably be very controversial.

3. Alternative 3 - represents a middle ground between alternatives 1 and 2. It allows future benefits to keep pace with approximately half of the growth in real wages. It would eliminate ________% of the long term deficit. This proposal could also be politically difficult.

The existing consensus in opposition to the current coupled system provides a forum for discussion of decoupling proposals. Therefore one of these three models could be proposed in connection with a short term financing proposal. However, these alternatives, particularly the two which include declining replacement rates would prove very controversial and raise some fundamental questions about the role of social security which we may not be fully prepared to address at this point.

STUDY OF SOCIAL SECURITY SYSTEM:

To allow time for the necessary data collection, for analysis of the broader structural issues and for education of the public and consensus building, it is our judgement that a comprehensive study is needed.

If you decide to defer legislative action on a short term financing proposal and/or decoupling, then the study group could address these issues over the next year.

Clarification of the role of social security in our society is necessary to insure its stability and continued public confidence. Some of the fundamental questions include the following:

- What should be the role of social security in the context of the overall pension system?
- What should be the role of social security in the overall tax system?
- What should be the role of social security in the context of economic growth?
- What should be the role of social security in terms of wage replacement vs. income redistribution (welfare)?

It is our judgment that Domestic Council members should assist in developing a framework for the study which clearly identifies the appropriate issues, and should assist in the selection of a group of outside experts. The experts would provide needed analysis and facilitate increased public awareness of the issues. Responsibility for overseeing the study could be housed in either the Domestic Council or the Office of the Secretary, HEW.

RECOMEMNDATION:

DECISION:

Propose decoupling:
Alternative 1: ________
Alternative 2: ________
Alternative 3: ________

Propose Study of Social Security: ____________

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

December 1, 1975

MEMORANDUM TO THE EXECUTIVE COMMITTEE OF THE ECONOMIC POLICY BOARD

From: Troika 2

Subject: Economic Assumptions for Short and Long-Run Budget Estimates

Attached is a draft memorandum for the President that will be discussed at a special meeting of the Economic Policy Board, 5:00 p.m., December 2, 1975.

Attachment

DRAFT 12/1/75

MEMORANDUM FOR THE PRESIDENT

FROM: Executive Committee of the EPB

SUBJECT: Economic Assumptions for the Budget

Issue 1: Long-Run Budget Projections

In the 1976 Budget and in the Mid-Session Review of that Budget, long-run outlay and receipts estimates were based on the assumption that real economic growth would proceed at a rate of 6.5 percent from the last quarter of 1976 through the end of 1980. It was carefully stated that this was a "projection" and not a forecast or a goal. The details of the projection are attached as Tab A. The implied unemployment rates were:

1977	1978	1979	1980
7.2	6.5	5.8	5.1

Administration spokesmen all said that they hoped to do better than the unemployment path implied by the projection.

This year we shall have to provide a forecast for 1976 and 1977 and long-run projections for the period 1978-81. The options regarding the long-run projections are outlined below.

Option 1 -- <u>Project a continuation of the 6.5 percent growth rate through 1981</u>.

<u>Considerations</u> -- Given our current forecast, which may be altered by Budget time, this would lead to a 4.4 percent average unemployment rate in 1981. Most economists would think this unreasonable unless a rapid acceleration of inflation was also assumed. The average unemployment rate over the last twenty years has been 5.2 percent. Moreover, changes in the composition of the labor force and in Government social programs may have altered the effective "full employment" rate.

It should also be noted that because of changes since the Mid-Session Review in the expected pattern of economic growth, the projected unemployment rates would be slightly higher than those published earlier. The following table compares the new data to those in the Mid-Session Review.

	1978	1979	1980	1981
New projection	6.7	5.9	5.2	4.4
Mid-Session Review	6.5	5.8	5.1	---

Option 2 -- <u>Project a 5.0 percent unemployment rate in 1981 and for the intervening years project the constant rate of growth which achieves this unemployment rate</u>. Given our current forecast this would imply an average growth rate of 5.8 percent. The implied unemployment rates are:

1978	1979	1980	1981
6.8	6.3	5.6	5.0

<u>Considerations</u> -- The projection might be taken to imply that the Administration is now using a 5.0 percent target for the unemployment rate rather than the 4.0 percent which earlier has been used to compute the "potential GNP growth path" or the "full employment budget". This option also implies that unemployment rates for the years 1978-80 will be higher than those published earlier. For example, the 1980 rate will be 5.6 percent rather than the 5.1 percent used in earlier projections.

Option 3 -- <u>Continue to project 6.5 percent growth for the 1978-80 period, but use a 1981 growth rate that brings us to, say, 5.0 percent unemployment in that year</u>. The implied growth rate for 1981 would be 4.6 percent.

<u>Considerations</u> -- Given the current forecast, the unemployment rates published for 1977-80 would be the same as those published under Option 1, i.e., rates only slightly higher than those published earlier. However, it would again appear as though 5.0 percent was our new long-run unemployment target. Also, a growth path of 6.5 percent for three years followed by a rate of 4.6 percent for 1981 would no longer look like a simple projection. It would look much more like a target path.

Option 4 -- <u>Publish a set of figures for 1981 consistent with an unemployment rate of 5.0 percent, but do not publish economic data for the years 1978 through 1980</u>. Budget estimates would have to be published for the intervening years, but it would be stated that these were based on an economic path derived by simple arithmetic interpolation between 1977 and 1981.

<u>Considerations</u> -- Despite the care with which last year's long-run estimates were described as simple arithmetic projections and not targets, some observers persisted in considering these as targets and calculated the GNP lost over the next five years because of "administration

policies." By not publishing data for the intervening years this issue may be defused somewhat.

However, we must publish budget estimates for the intervening years and we must state how they were derived from the economic assumptions. In other words, the information that has to be published will be sufficient to allow critical observers to derive an economic growth path and perform whatever calculations they wish. Moreover, if data on the intervening years is not published after publishing such data in the 1976 Budget and in the Mid-Session Review, we may risk calling even greater attention to the projections.

It should also be noted that the long-run economic assumptions are used intensively by Congressional and other budget analysts. A failure to be responsive to Congressional needs in this area could result in legislation that would require far more detail than we currently anticipate providing.

Option 5 -- <u>Attempt an economic forecast for 1978 and use a 6.5 percent real growth rate for 1979-81</u>.

<u>Considerations</u> -- In the 1977 Budget we wish to place much more emphasis on the effect of 1977 decisions on

outlays in 1978 and future years. These estimates may be given more weight if they are based on an economic forecast rather than on a projection which we do not claim to take seriously.

The problems with this approach are obvious. First, a 1978 forecast would not have much credibility since such forecasts are far beyond the capability of present forecasting models. Second, even though the uncertainties are enormous, it is likely that such a forecast would lead to estimates for the whole period that are more pessimistic than those published earlier.

There is another problem with all of the options which merits consideration. Our current forecast projects a growth rate for 1977 of 4.9 percent which is lower than the growth rate that would result for the period 1978-81 under any of the above options. This implies that if our forecast remains unchanged, the budget estimates will be based on a peculiar configuration of growth rates. They would be: 1976 - 7.1 percent; 1977- - 4.9 percent; and somewhere between 5.8 and 6.5 percent for the period, 1978-81.

Issue 2: Policy Assumptions for 1976 and 1977 Forecasts

The time schedule for the 1977 Budget implies that we must start an economic forecast on December 12. At that time we must provide our forecasters with judgments regarding Administration policies for the 1976-77 time period. This year unusual uncertainty regarding tax and energy policies makes this process very difficult. For your information, the major problems are as follows:

Problem (i) -- Tax cuts

Unless Congress acts in a surprising manner, it is impossible to assume that your recommended $28 billion tax cut goes into effect on January 1, 1976. This leads to the following questions:

1. What tax law should be assumed as of January 1?

2. Will the October 6 tax and spending proposals remain the same and what shall we assume about the effective date of the Administration proposals?

Problem (ii) -- Energy Policy

1. If it is assumed that the Conference Energy Bill is signed, it will be necessary to specify how you intend

to use the pricing authority under that Act. This plan need not be published, but it will be important to the economic forecast.

2. If the Conference Energy Bill is vetoed and we assume sudden decontrol plus a windfall profit tax with rebate, it will be necessary to specify when the new tax and rebates go into effect.

TAB A*

ECONOMIC ASSUMPTIONS FOR BUDGET PROJECTIONS[1]
(calendar years; dollar amounts in billions)

Item	Assumed for Purposes of Budget Projections 1977	1978	1979	1980
Gross national product:				
Current dollars:				
Amount	$1,891	$2,107	$2,335	$2,586
Percent change	12.6	11.4	10.8	10.8
Constant (1958) dollars:				
Amount	$897	$956	$1,018	$1,084
Percent change	6.5	6.5	6.5	6.5
Incomes (current dollars):				
Personal income	$1,515	$1,689	$1,874	$2,078
Wages and salaries	$978	$1,092	$1,211	$1,344
Corporate profits	$173	$193	$214	$237
Prices (percent change):				
GNP deflator:				
Year over year	5.7	4.6	4.1	4.0
Fourth quarter over fourth quarter.........	5.2	4.3	4.0	4.0
CPI:				
Year over year	5.3	4.4	4.0	4.0
December over December ..	4.8	4.2	4.0	4.0
Unemployment rates (percent):				
Total......................	7.2	6.5	5.8	5.1
Insured[2]..................	6.1	4.7	4.0	3.2
Federal pay raise, October (percent)	6.75	6.50	6.00	5.50
Interest rate, 91-day Treasury Bills (percent)[3].....................	5.1	5.1	5.0	5.0

*Source: Mid-Session Review of the 1976 Budget, May 30, 1975, Table 14, page 22.

[1] Based on extrapolations using a 6.5% rate of real growth in GNP for 1977-1980.

[2] Insured unemployment as a percentage of covered employment; includes unemployed workers receiving extended benefits.

[3] Average rate of new issues within period.