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THE WHITE HOUSE
WASHINGTON

Mr. President -

I will call you
about this memo
this evening. -

File

Don -
RBT

THE WHITE HOUSE

WASHINGTON

May 17, 1975

MEMORANDUM FOR: DON RUMSFELD
FROM: DICK CHENEY 
SUBJECT: Social Security

In the meeting this morning at 10:30 called to review Title IX regulations on sex discrimination, the subject of Social Security came up. No decision paper was done on Social Security. A briefing paper did go to the President late Saturday night on the subject.

According to Jim Lynn and Jim Cannon, the pressure for some decision on Social Security came from Weinberger who was present. Cap has to testify on Tuesday and wanted the President's guidance.

The basic issue is that outlays from the Social Security Trust Fund this year will exceed the income by about \$3 billion. Cap has to testify with respect to bringing the fund back into balance.

The options that were discussed include:

1. Raising the rate of the payroll tax.
2. Raising the base upon which taxes have to be paid.
3. A combination of raising the base and transferring collections from the Health Insurance Fund, which has a slight surplus ~~to~~ to the Social Security Fund.
4. An option which avoids taking a position on the question of taxes, criticizing the Congress failing to adopt the 5% limit on benefit increases and calling for work on major legislative reforms of the Social Security System to be effective at some future date.



All of the taxes Congress is proposing would not be effective until 1977. The President, I am told, gave Cap instructions as follows:

1. He is to criticize the Congress for failing to put a limit on benefit increases.
2. He is to support a recommendation to increase the tax rate.
3. He is to support a recommendation to increase the tax base.
4. He is to make the point that when Congress refuses to control spending, they then must take the responsibility for increasing taxes.

Arguments

I feel very, very strongly for a great many reasons that the instructions given to Weinberger should be withdrawn. I can think of nothing worse in the midst of the worst situation since the Great Depression than to have the President in favor of higher payroll taxes. Even though the increases would not take effect for 18 months, he would be in a position now with unemployment above 9% of advocating a higher tax rate.

I believe that the payroll tax is a very strong obstacle to increasing private sector employment. Keep in mind that any increase in the payroll tax paid by individuals has to be matched by businesses. Art Laffer has commented on the subject and we should focus on it in some depth before making the system any worse than it already is. In effect, the recommendation which the President has approved puts him in the **SOUP** since Congress failed to limit transfer payments (i. e. place a cap on Social Security benefit increases). The President is going to recommend tax increases for the middle American tax payer who has already been shafted by the welfare oriented tax cut legislation which was enacted earlier this year.

I cannot think of an issue better designed to encourage Ronald Reagan's candidacy than one which raises taxes on Republicans and gives benefits to Democrats. Aside from the policy problems with the decision, it is also very bad politics.

Most of all, I object to the manner in which the decision was made. Bill Simon, who is the Chairman of the Social Security Task Force, was not even present in the meeting.

No decision paper was prepared. The briefing paper was not circulated for comment.

The Economic Policy Board, which should be involved, was not involved.

One of the concerns, I am told, which was used to support the Weinberger recommendation for higher Social Security taxes is ^{the} argument that unless we increase the payroll tax, Congress will pass legislation which would make up the deficit in the cash flow accounts of the Social Security Trust Fund by tapping general revenues.

Recommendations

I strongly urge that you call the President this evening and relay to him the above, and I urge you to recommend that he change his guidance to Weinberger as follows:

Cap should criticize the Congress for their failure to limit government spending. He should criticize them for their failure to adopt a ceiling on increases in Social Security benefits. He should indicate that the financing problems in the Social Security System are merely symptoms of a much larger problem which is the long-term weakness of the entire Social Security System.

He should indicate that the Administration, specifically the Domestic Council, at the direction of the President, is undertaking a major long-range study of the Social Security program. That study will

be completed in time for the President to include recommendations in his State of the Union Message next January.

In addition, he should indicate that the President is prepared to oppose any additional tax increases which are designed to compensate for the unwillingness and the inability of the Congress to exercise restraint in federal spending programs.

P.S. I am told that Bill Simon does not believe the problem requires immediate attention. He believes that the payroll tax revenues will be higher than forecast, and therefore the deficit will be less than \$3 billion.

THE WHITE HOUSE
WASHINGTON

May 17, 1975

MEMORANDUM FOR: DON RUMSFELD
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*Cap testimony to Pres.
by noon Mon. -*
*Talk about deficit -
then choices to be
stated - Cong. can
raise taxes - give
them the choice.*

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- Probs. -
- 1.) Decision not carefully considered
Simon not present, etc. correct
 - 2.) Does nothing to ~~correct~~ ^{correct} the long term nature of the probs.
 - 3.) Relieves pressures for basic reform in Jan.
 - 4.) Involves raising taxes instead of reducing spending.
 - 5.) When added on top of tax cut which discriminated against taxpayers + benefited those who don't work - it results in a ~~to~~ significant move toward reducing the benefits of working + increasing the benefits of not working
 - 6.) Taxes GDP - ~~add-on~~ to provide benefits for Dems.
 - 7.) Pres. should be for ~~supporting~~ tax cuts + against tax increases - he should be for a bid on spending + against spending increases.
 - 8.) Should be opposed to any tax increase ~~to~~ which stems from a Congressional inability to control spending -
 - 9.) Should address entire question of total tax burden - can't address just the pieces of the social security tax.
 - 10.) Don't have any good analysis of econ. impact

THE WHITE HOUSE

WASHINGTON

May 16, 1975

MEMORANDUM FOR: THE PRESIDENT
FROM: JIM CANNON
SUBJECT: Social Security

The purpose of this memorandum is to present for your decision key issues regarding the financing of Social Security. Behind all of these issues lie two questions:

1. Whether you should propose before 1977 some kind of increase in the payroll tax.
2. If you should, when should you propose the increase.

CURRENT SYSTEM

Under present law benefits are financed out of current income from Social Security taxes. These taxes are applied equally to employer and employee. The revenue flows through trust funds

- one set of funds for Old Age, Survivors, and Disability (OASDI) benefits.
- and a Medicare fund to finance health care for the aged.

Benefits are related to actual income (the wage base subject to Social Security taxes) but are also adjusted according to the cost of living. The wage base subject to taxes is also adjusted for inflation.

Under present law:

	<u>Calendar Year</u>				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
OASDI Tax	4.95%	4.95	4.95	4.95	4.95
Medicare Tax	0.90	0.90	1.10	1.10	1.10
Total Tax	<u>5.85</u>	<u>5.85</u>	<u>6.05</u>	<u>6.05</u>	<u>6.05</u>
Earnings Base	15,000	16,500	18,300	19,800	21,300



ISSUE

A. Financing

1. Short Term

Since the Social Security system is exceedingly sensitive to changing economic conditions most recent trends indicate that Old Age, Survivors, and Disability outgo will exceed income by a widening margin so that trust fund reserves will be exhausted in the early 1980's. The Medicare Trust Fund is projected to be relatively stable.

2. Long Term

Current demographic projections and recent provisions for automatic cost of living adjustments which provide a double benefit increase for current workers raise serious questions about the fiscal stability of the system over the next 50 years.

B. Selected Advisory Council Recommendations

The Advisory Council on Social Security recommended action to deal with a number of specific items such as:

- maintaining retirement test
- equal treatment of men and women
- minimum benefits
- older disabled workers

STRATEGY FOR DEALING WITH ISSUES

Secretary Weinberger must testify before Ways and Means on May 20th and recommends:

1. A specific decision be made now on a proposal to deal with the short term financing problem and announced in his May 20 testimony.
2. In that testimony we should indicate the Administration intends to submit in January a proposal to deal with the long term issues.
3. Not dealing now with the selected Advisory Council recommendations with the one exception of equal treatment for men and women which has recently been subject of a Supreme Court decision.



REACTIONS TO THIS PROPOSED STRATEGY

I recommend concurrence with strategy items two and three above. No objections have been raised on these points and

- the long term problem needs to be addressed and January would be an appropriate point in time.
- equal treatment of men and women has been the subject of a court decision and the options available now are not likely to change with time.

There is, however, a sharp difference of opinion on the key question, point one, of whether the short term problem should be:

- dealt with now and a specific option should be announced by the Secretary on May 20th, or
- should be included with the longer term problems and a single comprehensive plan to stabilize the Social Security system should be presented in January 1976.

ARGUMENTS IN FAVOR OF ACTING ON THE SHORT TERM PROBLEM NOW

the public probably doesn't know about it. veto it. no plus in this.

1. The public is concerned about the stability of the system and a specific proposal now will help calm that concern.
2. Failure to present a specific recommendation could provide increased impetus to Congressional moves toward general revenue funding.
3. Action now would put the Administration in the position of taking the initiative.

ARGUMENTS AGAINST ACTION NOW

1. Since proposals, either now or in January, would not become effective until 1977 at the earliest there is no need to make a decision immediately.
2. OMB believes the data furnished by HEW is insufficient to make a decision as important as this.
3. Any adjustments now have a long term affect anyway so they will have to be integrated in the long term proposal.



4. The long term proposal is needed not just for financial problems but also for basic structural changes. Action now could remove the leverage needed to gain support for these changes.

STRATEGY DECISIONS

Option I: Act now on the short term problems by having Secretary Weinberger announce a specific proposal on May 20th.

Favored by: HEW
Bill Seidman

Option II: Defer action on the short term problem, proceed with work on both long and short term problems and submit in January 1976 a single comprehensive plan for stabilizing the system.

Favored by: OMB Treasury Department
Phil Buchen Alan Greenspan

RECOMMENDATION

That you approve Option II, deferring action on short term issues now and including short term issues in a single comprehensive plan in January 1976.

Approve _____ Disapprove _____

SPECIFIC OPTIONS FOR ACTION NOW

The Secretary suggests three basic options if you wish to deal now with the short term problem. He suggests that the aim be to maintain OASDI Trust Fund reserves of no less than 30 percent of outgo. The options available are:

1. TAX RATE ONLY OPTION: Simply raise the tax rate.

-- In 1977 increase total tax from 5.85 to 6.20. The OASDI tax would go from 4.95 to 5.30. In 1978, take the scheduled .20 percent Medicare tax increase and apply it in part. A total tax of 6.20 would apply in 1977 and 6.40 in 1978.

Pro

1. Would stabilize trust fund at about 36 percent of outgo.



2. Utilizes relative stability of Medicare Trust Fund to assist troubled OASDI system.
3. Has promptest corrective affect on trust fund.
4. Would have the least detrimental affect on savings flow and capital investment.

Con

1. Would impact most heavily on low income families reinforcing charge that Social Security tax is regressive.
 2. Largest total tax increase of any option.
 3. A higher tax yields no increase in benefits by itself.
2. BASE/RATE OPTION A: Modest increase in earnings base coupled with some tax increase.

-- Rather than the scheduled 1977 increase to \$16,500 in earnings base subject to tax, increase the base to \$18,000. In addition, raise total tax rate in 1978 from scheduled 6.05 to 6.30. Part of scheduled Medicare increase would be shifted and coupled with an additional increase to protect OASDI Trust Fund.

Pro

1. Would spread burden to higher income levels thus moving toward greater progressivity.
2. Change in earnings base is not severe and will have a lesser affect on savings.
3. Occurs in conjunction with previously scheduled increases.

Con

1. Tax increase beyond present law.
2. New level of wages subject to tax.
3. Slowest affect on stabilizing trust fund.



2. BASE/RATE OPTION B: Increase wage base substantially and shift part of Medicare increase.

-- This proposal would increase wage base to \$21,000 in 1977, shift part of the 1978 Medicare increase to OASDI but not increase total tax beyond what present law requires.

Pro

1. Total tax is not increased beyond present law.
2. Moves substantially toward greater progressivity.
3. Has more immediate corrective affect on trust fund outgo.
4. It gives something back in higher benefits to those who will be paying the higher rate.

Con

1. It has long been agreed that Social Security protection should not extend to the total earnings of covered workers for this coverage would substitute for private insurance funded in the private sector. Under this option, 95 percent of the covered work force would have their entire salary protected under Social Security.
2. Concentrates total cost of correcting trust fund problems on the higher income group, thus having the most severe affect on savings flow.
3. This is a short-term proposal, but the effect of an increase in the wage base goes well into the long range future. A wage base increase results in a higher base for the computation of benefits. It increases the cost of the system in the future (i.e., not all of the revenue is available for covering the deficit. Some is lost in higher future benefits). Thus, it is a more costly and permanent change than a tax rate increase for the same amount of revenue.



STAFF COMMENTS

Robert Hartmann: Base/Rate Option A

Jack Marsh: Tax Rate Only Option with Base/Rate Option A
as a fall back position.

Alan Greenspan: "If there is to be action now...tax rate
only....more progressivity reduced savings
flow and capital investment."

Phil Buchen: "Any proposal advanced at this time...should
combine increases in both the tax rate and
earnings base."

Bill Seidman: Supports the three recommendations by Secretary
Weinberger including Base/Rate Option B.

RECOMMENDATION

I recommend that if you choose to act now you select the
Base/Rate Option A which provides for a modest increase in
earnings base and a tax increase.

Approve _____ Disapprove _____







THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D. C. 20201

May 2, 1975

MEMORANDUM FOR THE PRESIDENT

FROM : Caspar W. Weinberger

SUBJECT: Social Security

I have been called before the Congress later this month to testify on the Administration's position on the short-term financing problem in the social security system and the longer term financial and structural problems and prospects for social security. In addition, the Administration has not yet, but should react more comprehensively to the Social Security Advisory Council report delivered to you and the Congress (and made public) in March. You and I commented unfavorably on its recommendation to finance Medicare from general revenues, and have indicated general endorsement of some revision in the future benefit structure. We have not, however, reacted to its other recommendations on benefits and coverage, or to its specific proposals for solving short- and long-term financial deficits.

This memorandum highlights a somewhat longer decision memorandum that is attached.

Background

There is a serious short-term financing problem in social security cash benefit programs. This problem was understated in the Advisory Council report, but later cost estimates are now available, and are known publicly. The forthcoming Trustees Report will underscore it. Given current projects and current law, outgo exceeds income by a widening margin so that reserves, now 66 percent of annual outgo, dwindle to nothing in the early 1980's.

These problems arise because the social security system is exceedingly sensitive to changing economic conditions. The recent high inflation rates followed by recession have caused large unanticipated reductions in income and increases in outgo. Also Congress has increased benefits by about 70% in the last 5 1/2 years.

Beyond the near-term problems, there are a series of interrelated financing issues. These issues are caused by the demographic shift



toward a proportionately larger aged population as a result of falling birth rates, and by the current computational structure for social security benefits which automatically adjusts the benefits of future retirees in such a way as to overcompensate for inflation.

The Congress is aware of these issues, and plans to debate the near-term issue soon. The relevant committees have initiated a review on a more deliberate schedule of the long-term issue. The Advisory Council has offered its solution. Many ideas, including general fund financing, exist in the Congress. A debate of immense importance is under way.

Discussion

The first problem at hand is near-term financing. In brief, we need more revenue, even though current law provides for some increases in the future. (The earnings base on which payroll taxes are collected goes up for both social security cash benefits and Medicare under the indexing features of current law. Medicare also has a small payroll tax rate increase scheduled in law for 1978.) In my opinion, the realistic alternatives for increasing revenues are a small increase in payroll tax rates, an increase in the payroll tax earnings base, or a combination thereof. While the Advisory Council recommended general revenue financing, I strongly believe that we should continue to maintain our stance against it. I regard the Advisory Council recommendation as a first step toward destroying the discipline of connecting benefits and taxes.

The timing of the increase in revenues is partly judgmental, but is strongly determined by the perception of how large or how small the reserve should be. Not long ago, we thought it should be 75-100 percent of annual outgo. There is no "right" number, but I think less than about 30 percent would not suffice in recessionary periods and would begin to erode public confidence in the system. If this is correct, then increased revenues should start to flow in 1977. In addition, the longer we wait to increase revenues, the higher and sharper the increases in any one year must be.

We also need to grapple with the long-term issues, correctly identified by the Advisory Council. There is a substantial consensus that we need to stabilize the future benefit structure, but the Advisory Council solution is only one of many. Like the Congress seems prepared to do, I believe we should work our way carefully through this problem, looking toward a proposal to Congress next January. With respect to other Advisory Council recommendations on benefits and coverage, I think we should openly set those aside for now as too costly to consider. I would make an exception for those low-cost items related to unequal treatment of men and women, particularly in light of the recent Supreme Court decision in this area.

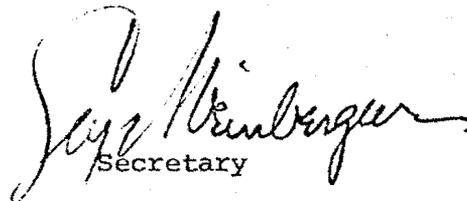


The final area of concern relates to the timing of Administration proposals to solve the short-term financing problem. I believe we must take a position on this subject. We do, however, have the choice of announcing now our specific proposals for increasing short-term revenues and waiting until next year to put forward long-range solutions, or alternatively acknowledging the issues now and announcing all our proposals in January. The advantages of proceeding now with a specific proposal include: attempting to lead the debate, preempting or competing early with other solutions we would oppose, and avoiding a new tax increase proposal in 1976. Waiting would allow us to tie the short- and long-range proposals together in one comprehensive Administration plan.

Recommendations

In the attached memo which contains the specific decision options, I am recommending that you choose the following:

- . Adopt a specific proposal now to deal with the short-term financing problem (through 1980). The proposal would adjust upward the earnings base beginning in 1977 but would not alter the combined social security/Medicare payroll tax rate currently scheduled in law.
- . Reconfirm endorsement of need for legislation to stabilize future benefit structure and proceed with studies of alternative ways of accomplishing this. Ignore other Advisory Council financing recommendations that are based on cost estimates that are now out of date.
- . With the exception of selected measures on equal treatment, set aside for now Advisory Council recommendations on benefits and coverage in light of economic conditions and the overriding importance of the short- and long-term financing problems.


Secretary

Attachment





THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D. C. 20201

May 2, 1975

MEMORANDUM FOR THE PRESIDENT

Through: Honorable James M. Cannon
Domestic Council

med
Purpose

The purpose of this memorandum is to obtain Presidential decisions concerning:

- Rx*
1. The Administration's response to the recommendations of the 1975 Advisory Council on Social Security.
 2. The financing of deficits (both short- and long-term) facing the social security system.

Each of these topics is discussed separately below. At the end of each topic you will find a set of options for Presidential decision.

I. ADVISORY COUNCIL RECOMMENDATIONS

On December 11, there was a briefing for the President on social security financing problems and on the major social security issues that have been addressed by the Advisory Council. An outline of each of the Council's major recommendations was also contained in the enclosed memorandum of January 24 (Tab A).

The Council's report, which has been transmitted to the Congress, recommended a series of cash benefit proposals to (1) modify coverage and benefits; (2) stabilize the future benefit structure; and (3) finance both the short- and long-term deficit.

Coverage and Benefit Modifications

The first group of proposals affecting coverage and benefit provisions (by eliminating differences in the treatment of men and women, liberalizing the retirement test, changing



the definition of disability for older workers, etc.) are described in Tab A. Some of them have merit. The Council's recommendations for promoting equal rights for men and women under social security are of particular interest at this time in light of the recent Supreme Court decision in the Wiesenfeld case which held unconstitutional the provision of present law under which social security benefits are payable to a widow with a child beneficiary in her care but not to a similarly situated widower. In the near future the Department of Health, Education, and Welfare will forward recommendations for changing those provisions of the social security law which differentiate between men and women. (The short-term cost of these legislative recommendations is not large enough to have an effect on the short-term financing options discussed in part II of this paper.)

Almost all of the Council's other benefit recommendations involve additional program costs. All things considered, it is recommended that this group of recommendations be opposed at this time on the grounds that the current economic outlook and the tenuous financial status of the social security system militate against these changes in benefits and coverage. Such a position would be consistent with the President's "no-new-starts" policy.

Stabilizing the Benefit Structure

The subject of stabilizing the benefit structure replacement rates was discussed in some detail in a meeting with the President on December 11 and in the enclosed memorandum of December 23 (Tab B). It is recommended that the President strongly endorse the principle of stabilization and the need to develop and adopt a stabilization proposal as quickly as possible but that we consider the Council's model as one among a number of possible alternatives. The Administration should take the position that it is examining alternative ways of accomplishing the objective and will present a specific recommendation to the Congress at a later date.

Financing the Deficits

As a practical matter, the Council's financing plan is not very helpful:

- First, it will not completely solve the long-term financing problem. While their plan would finance a long-term deficit of over 3 percent of taxable payroll, the latest actuarial estimates suggest a deficit of over 5 percent.



- Moreover, the Council would finance Medicare from general revenues and transfer Medicare payroll taxes to bail out the old-age, survivors and disability insurance (OASDI) trust funds. The Administration should oppose this and all other general fund financing schemes.

Another consideration is that it would probably be a mistake to decide on a long-term financing plan before a decision is made concerning a specific benefit stabilization plan, since stabilization will substantially reduce the long-term deficit.

Suggested Presidential Decisions Concerning Advisory Council Report

1. Proceed with development of proposals on equal treatment of men and women and reject the Council's other proposed modifications in coverage and benefits not on their merits, but on grounds that the system cannot afford the cost.

Approved _____ Disapproved _____

2. Endorse legislation to revise and stabilize benefit structure and indicate that Administration will present specific plan to Congress.

Approved _____ Disapproved _____

3. Concur in Council's conclusion that steps must be taken to solve system's financing problems; reject Council's specific plan; and develop an Administration financing plan.

Approved _____ Disapproved _____



II. FINANCINGA. Long Term

Long-range actuarial cost estimates indicate that the old-age, survivors, and disability insurance system has a substantial long-range deficit. It is estimated that the program is under-financed over the customary long-range valuation period of 75 years by an average annual amount equivalent to 5.32 percent of taxable payroll, with the larger part of this deficit occurring after the turn of the century. A significant part of the high long-range cost of the program in the next century is due to the projected increases in benefit levels relative to earnings levels under the automatic benefit adjustment provisions of present law. The previously mentioned recommendation to stabilize the future benefit structure would have a significant favorable impact on this long-range deficit. The Department is studying alternative proposals that would result in such stabilization. However, until a specific plan to accomplish this is developed, a specific method of dealing with this long-range deficit should be postponed. There is adequate time to deal with this long-range problem.

B. Short Term

The immediate financing problem--probably the most critical of the several issues facing the social security system--is what to do about the short-term deficit facing the cash benefit part of the system. At the time the President was briefed in December, the yearly deficits in the cash benefit trust funds beginning in 1976 were expected to be small; it appeared that these deficits could be covered over the next 5 or more years without reducing the reserve to an unacceptable level.

Projections of the status of the trust funds were revised later in December, when the Council of Economic Advisers' economic assumptions for the 1976 budget became available. Current projections of program costs are based on more recent assumptions developed for use in the 1975 Trustees' reports which will be submitted to the Congress next week. (These latest assumptions are used throughout this memorandum.) Cost estimates based on the latest economic assumptions show (as did those based on the 1976 budget assumptions) that the reserve in the cash benefit funds will be impaired almost immediately and will be completely exhausted by the early 1980's.



Social security is of course a dynamic system sensitive to changes in the economy, and shifts in the short-term economic outlook can have a significant effect on trust fund income and outgo. Income from the payroll tax is strongly influenced by the amount and duration of unemployment and the rate of increase in wages. With anticipated benefit increases tied to the cost-of-living projections, outgo estimates can vary sharply if CPI assumptions are changed in any significant way. Basically, as compared to the 1976 budget assumptions, the Trustees' report assumptions show a slower rise in the CPI over the next several years, project unemployment rates to be somewhat higher in 1975 and lower in 1978-1980, and are less optimistic about productivity improvements in the latter part of this decade. (See Tab C.)

The tables below show the status under present law of the cash benefit (OASDI) trust funds through 1980 under the assumptions developed by HEW for the Trustees' reports.

Status of Old-Age, Survivors and Disability Insurance Trust Funds
1975-1980 Existing Legislation
(Amounts in Billions)

	Calendar Year						
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Income.....	\$66.5	\$72.3	\$81.8	\$91.1	\$100.3	\$109.1	
Outgo.....	69.5	78.1	87.5	97.1	107.1	116.8	
Net (surplus/ deficit).....	-3.0	-5.8	-5.8	-6.0	-6.8	-7.7	
Reserve at start of year:							
Amount.....	\$45.9	\$42.9	\$37.1	\$31.3	\$25.4	\$18.6	\$10.9
As percent of year's outgo...	66%	55%	42%	32%	24%	16%	9%



Decisions on how to deal with the central issue of short-range financing of the cash benefits part of social security will necessarily involve resolution of three important sub-issues: the treatment of proposed social security legislation set forth in the 1976 budget; the timing of any financing initiative; and the specific nature of such an initiative.

1. Effect of Social Security Cost-Control Legislation on Financing

The Administration has proposed a number of administrative and legislative initiatives which would have the effect of holding down social security costs. (A complete list of these proposals is included at Tab D.) The key measures which would have a significant effect on the funds are legislative proposals to (a) place a one-time, 5-percent limit on the social security cash benefit increase payable in July 1975, and (b) institute greater Medicare cost-sharing.

It now appears extremely unlikely that the Congress will enact either the 5-percent cap on social security benefits or the Medicare cost-sharing legislation. (The Senate Finance Committee, in their budget considerations, did not accept the 5-percent cap, and more than 50 Senators have co-sponsored a Senate resolution opposing the cap. The House Ways and Means Committee has expressed strong sentiment against it.) Nor, to the best of our knowledge, is there any Congressional support for Medicare cost-sharing legislation. The Congress refused to consider this type of legislation 2 years ago.

As a practical matter, therefore, it would seem unwise to predicate a financing plan on the assumption that the Administration's proposed social security cost-reduction legislation will be enacted. On the other hand, it is important to understand the effect that enactment of these proposals would have on the trust funds and their financing arrangements. We have therefore shown at Tab E an analysis of the effect of the proposed cost-control legislation and of a related financing plan that could be proposed assuming enactment of that legislation. The remainder of this paper assumes that the legislation will not be enacted.



2. Timing

There are two questions with respect to the timing of Administration short-term financing proposals: When must additional revenue-producing measures take effect? When should the Administration submit a financing proposal to the Congress?

The timing of a legislative effective date raises broad economic and political considerations, as well as the obvious concerns about the fiscal integrity of the social security system and public confidence in the system. Viewing the issue solely from the position of stewardship of the trust funds, the Administration would have to advocate legislation to provide additional financing at the earliest possible moment--that is, beginning in calendar 1976, when, under present law, expenditures from the cash benefit funds will significantly exceed income. It is recognized, however, that in the current economic situation such a proposal is strongly contraindicated.

The basic premise therefore should be that, due to the state of the economy, no tax increases or other social security revenue-producing measures should be proposed which affect calendar years 1975 or 1976. Then the timing and design of financing alternatives should employ the following criteria:

- a. Further revenue development can be held in abeyance until, but not beyond, a point where the reserve level falls so low as to seriously erode public confidence. (This is a judgmental matter.)
- b. The trust funds should not be allowed to operate with an annual deficit for any longer than necessary. In other words, income to the funds should exceed outgo as soon as it can be safely assumed that additional revenue-producing measures will not adversely affect economic recovery.
- c. Whatever the revenue-producing measure(s) adopted, it should not produce a sharp rise in the tax rates in any single year.



Considering the first criterion--public confidence level of the reserves--trust fund balances must be at least stabilized at (and not fall below) a level equal to roughly one-third of annual outgo. (Ideally, the financing plan should produce or trend toward a higher level--say 50 percent--but there is also a need to restrain tax increases in the near future.) The one-third level is to a certain extent arbitrary; it is probably as low as can be safely countenanced, given previous public expressions that the reserve should be set at 100 percent of annual outgo. Under present law, the reserve level of the cash benefits trust funds will have declined to the one-third level (32 percent) by the beginning of 1978. Thus, any financing plan based on present law must either (1) generate additional OASDI revenues beginning in 1977 or (2) involve a substantial increase in revenues effective January 1, 1978.

Although implementation of additional financing measures can be delayed until 1977 or beyond, depending on circumstances, there remains the question of when to propose financing legislation. On balance, the Administration should introduce legislation this year, the earlier, the better. Controversy and public concern about the financing of the system is building rapidly, and release of the Social Security Trustees' reports this spring, as required by law, will add fuel to the fire. (The reports will increase public awareness of the deficit.) The Congress is almost certain to take the initiative if the Administration does not. Absent an Administration initiative, the forces favoring major general revenue financing of the trust funds would likely play a stronger hand, particularly in light of the Advisory Council recommendations. We believe that in light of these considerations it is desirable for the Administration to take the initiative promptly, rather than delaying until a comprehensive proposal dealing with both the short-range and the long-range situation could be presented.

The Subcommittee on Social Security of the House Ways and Means Committee has scheduled hearings for later this month on the status of the trust funds and possible financing initiatives. These hearings would provide an ideal forum for presenting the Administration's plans.



3. Method of Financing

a. General Approach

There are four possible sources of trust fund revenue which can be used either singly or in combination. All require legislation. There are:

- Increased payroll tax rate (employer and employee, alike).
- Increased earnings base (the maximum annual amount of earnings to which the tax rate is applied).
- Transfer of tax income from Medicare funds. (Existing law calls for an increase in the Medicare tax rate in 1978; some of the income from this increase is more than necessary to meet short-term needs.)
- General revenue financing.

Consistent with previously stated Administration views, the Administration should continue to oppose any financing proposal involving substantial general revenues.

Further, unless it is assumed that the proposed cost-control legislation is enacted, any proposal to rely solely on tax rate increases would involve significant tax rate increases.

The Department's preferred approach combines increases in the earnings base with an adjustment in the tax rate schedule to transfer some income from Medicare to OASDI. The earnings base will increase annually due to the "automatic" provisions of present law; the Department's preferred approach would speed up the rate of the increases in the earnings base that will be produced by the "automatic" provisions of present law. Under one of the two earnings base/tax increase options that we are proposing, the total tax rate (OASDI-Medicare combined) would increase; under the other, the total tax rate would be unchanged from present law.



A tax-rate-increase-only approach and an earnings base increase combined with a tax increase would be significantly different in their impacts on the taxpaying population at different wage levels. While any plan that depends entirely on an increased tax rate will impact on all workers, the greatest relative impact would fall on the low-paid worker as compared with the higher-paid worker (i.e., the tax is regressive). A plan which relies in part on an increase in the earnings base would be more progressive, spreading more of the burden toward the upper-income worker. The degree to which this occurs depends, of course, on how rapidly and to what level the earnings base is increased.

An increase in the earnings base reduces the cost of the social security program expressed as a percentage of payroll and therefore makes it possible to meet long-term program costs with lower tax rates than would otherwise be necessary. An earnings base increase also increases the protection provided for higher-paid workers by increasing the proportion of their earnings that is counted for benefit purposes.

As a practical matter, any plan incorporating an increase in the earnings base would automatically increase income to the Medicare program but would not affect outgo. This, in turn, would permit a transfer of a greater amount of Medicare income to the cash benefit programs, thereby helping to hold down the combined OASDI/Medicare payroll tax rate needed to finance the entire system.

It is recommended that any plan to improve the short-range financing of the OASDI system include provision for transferring any unneeded Medicare income created during the period to the cash benefit (OASDI) trust funds. The transfer of taxes now scheduled for Medicare to OASDI is a critical element in all the financing plans discussed below.

The proposed reallocation of Medicare taxes could have implications for the Administration's Comprehensive Health Insurance Plan (CHIP) when the Administration resubmits it. Comprehensive Health Insurance Plan contemplates the use of the Medicare taxes to finance the principal costs of coverage for the aged. The plans presented provide sufficient financing for Medicare and for that part of CHIP that is to be financed from payroll taxes.



It should be recognized that a proposal to transfer income from Medicare may lead to a need to increase future scheduled Medicare taxes. While there will be a Medicare surplus in the near term, under present law, the outlook is for a small deficit over the full 25-year Medicare valuation period. To the extent that funds are "borrowed" from this fund today, additional revenue-producing measures may be required in later years.

b. Specific Financing Approaches

The following points will help to put the alternatives presented below into perspective. This review of the status of the funds and their financing requirements is limited to the period ending in 1980. The objective is to provide the minimum financing necessary to sustain the cash benefit trust funds through 1980 (i.e., keeping the ratio of assets to outgo of the funds at no lower than one-third in the latter part of the decade). This has been done on the assumption that new long-term financing provisions will be enacted and in effect by the start of the next decade.

(i) Tax Only Approach

The table below compares the tax rates scheduled in present law with the tax rates that would be necessary to prevent the OASDI trust funds from falling below a level of one-third of a year's outgo and to maintain the funds at about 36 percent of outgo if there were no increases in the earnings base over those that would go into effect automatically under present law.

	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Present law</u>					
OASDI tax	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare tax	0.90	0.90	1.10	1.10	1.10
Total tax	<u>5.85</u>	<u>5.85</u>	<u>6.05</u>	<u>6.05</u>	<u>6.05</u>
Earnings base	\$15,000	\$16,500	\$18,300	\$19,800	\$21,300
<u>Tax only approach</u>					
OASDI tax	4.95	5.30	5.40	5.40	5.40
Medicare tax	0.90	0.90	1.00	1.00	1.00
Total tax	<u>5.85</u>	<u>6.20</u>	<u>6.40</u>	<u>6.40</u>	<u>6.40</u>
Earnings base (same as present law)					



Under this approach a large, immediate (1977) increase in tax rates would be necessary and the total tax rate through 1980 would be significantly higher than under present law. Also, as mentioned earlier, this approach would impact most heavily on low-income earners. These considerations raise serious doubts about such a tax only approach. (Detailed information on this option appears at Tab F.)

(ii) Base/Tax Approach

On balance an approach involving a combination of earnings base and tax rate increases seems preferable. The following table sets forth two options. One shows modest base increases combined with a 1978 tax increase that goes significantly beyond the increase scheduled in present law; the other shows fairly substantial base increases--increases that would make it possible, with a reallocation of the Medicare tax, to avoid a total tax increase in excess of that scheduled for 1978 in present law.



	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Present law</u>					
OASDI tax	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare tax	<u>0.90</u>	<u>0.90</u>	<u>1.10</u>	<u>1.10</u>	<u>1.10</u>
Total tax	<u>5.85</u>	<u>5.85</u>	<u>6.05</u>	<u>6.05</u>	<u>6.05</u>
Earnings base	\$15,000	\$16,500	\$18,300	\$19,800	\$21,300
<u>Option A</u>					
OASDI tax	4.95	4.95	5.30	5.30	5.30
Medicare tax	<u>0.90</u>	<u>0.90</u>	<u>1.00</u>	<u>1.00</u>	<u>1.00</u>
Total tax	<u>5.85</u>	<u>5.85</u>	<u>6.30*</u>	<u>6.30*</u>	<u>6.30*</u>
Earnings base	\$15,000	\$18,000*	\$20,700*	\$22,500	\$24,300
<u>Option B</u>					
OASDI tax	4.95	4.95	5.10	5.10	5.10
Medicare tax	<u>0.90</u>	<u>0.90</u>	<u>0.95</u>	<u>0.95</u>	<u>0.95</u>
Total tax	<u>5.85</u>	<u>5.85</u>	<u>6.05</u>	<u>6.05</u>	<u>6.05</u>
Earnings base	\$15,000	\$21,000*	\$24,000*	\$26,100	\$28,200

* Changes from present law in the total tax rates and earnings bases required for each option are identified by an asterisk in the year they occur. An asterisk on an earnings base amount denotes that automatic increase provisions in present law would be overridden by a legislative change affecting the amount of the base in that year, but not affecting the functioning of the automatic provisions in subsequent years.



The following table indicates the effects of these two options on the OASDI annual deficit and on the trust fund reserves. (Detailed information on these options appears at Tab F.)

	OASDI		Reserves at Start of			
	Income Minus		Year as a Percentage of			
	Outgo		Outgo During Year			
	(in Billions)		OASDI		Medicare	
	1977	1978	1978	1981	1978	1981
Present law	\$-5.8	\$-6.0	32%	9%	69%	90%
Option A	-4.2	3.0	34	36	71	74
Option B	-2.0	2.5	36	36	73	71

In order to provide some idea of the impact of the alternative short-range financial approaches on individual workers, the annual social security taxes for median workers and high-paid workers under present law, under a tax only approach, and under the two base/tax options are shown below. The table clearly shows that increasing the earnings base (base/tax options) would reduce the relative share of the additional taxes that would be borne by low-paid workers and raise the share borne by the higher-paid workers.

SOCIAL SECURITY TAX LIABILITY

	Employee with wages equal to Estimated Median Wage for Male Wage Earners*				Employee with wages of \$24,000 or More			
	1975	1976	1977	1978	1975	1976	1977	1978
Present law	\$479	\$508	\$554	\$636	\$825	\$878	\$ 965	\$1107
Tax only option	479	508	592	673	825	878	1031	1171
Base/Tax Option A	479	508	554	662	825	878	1053	1304
Base/Tax Option B	479	508	554	636	825	878	1229	1452

*Estimated median wages for male wage earners: \$8180 in 1975; \$8687 in 1976; \$9469 in 1977; and \$10511 in 1978.



Another way of evaluating the effect of the tax increases contemplated under present law and under the alternative approaches is illustrated below.

Percent Increase in Combined
OASDHI Tax Rates, 1975-78

<u>OASDHI Tax Rates</u>				
	<u>1975</u>	<u>1978</u>	<u>Increase</u>	<u>Percent Increase</u>
Present Law	5.85	6.05	.20	3.4%
Tax Only Option	5.85	6.40	.55	9.4%
Base/Tax Option A	5.85	6.30	.45	7.7%
Base/Tax Option B	5.85	6.05	.20	3.4%

Suggested Presidential Decisions on Financing and Timing of Public Announcements Concerning Social Security

1. Endorse a two-part financing plan as follows:

Part I. A proposal now to provide short-term financing--through 1980--to handle the immediate problem and allow sufficient time to reform benefit structure and develop a long-term financing plan based on such reform.

Part II. An integrated long-term financing and revised benefit structure plan to be submitted early next year.

2. Adopt financing plan represented by

Tax Only Option _____

Base/Tax Option A _____

Base/Tax Option B _____

Other _____

HEW recommends Base/Tax Option B.



3. Authorize the Secretary to present to the Congress the Administration's posture as reflected by the decisions indicated in this paper.

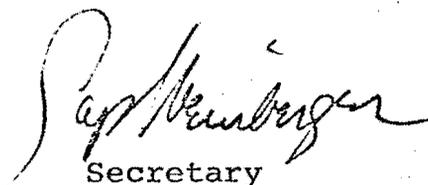
Approved _____ Disapproved _____

HEW recommends that the Secretary be authorized to present the Administration's posture on or before his appearance before the House Ways and Means Committee, scheduled by the Committee for mid-May.

4. Authorize the Secretary to proceed with the preparation of legislative proposals consistent with the decisions above.

Approved _____ Disapproved _____

HEW recommends approval.


Secretary

Enclosures

- Tab A - Memorandum for the President of 1/24/75
- Tab B - Memorandum for the President of 12/23/74
- Tab C - Discussion of Economic Assumptions
- Tab D - Administration Cost-Control Proposals
- Tab E - Effect of Cost-Control Proposal
- Tab F - Effect of Financing Options



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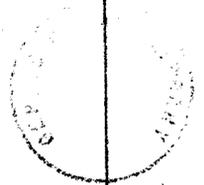
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SEPARATOR SHEET

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January 24, 1975

MEMORANDUM FOR THE PRESIDENT

As you have no doubt learned from press reports, the Advisory Council on Social Security met over the weekend of January 18 and 19. (Since the Council's meetings were open to the public, the press has been reporting major Council actions as they have occurred.) This was the last meeting of the Council, which has been studying Social Security since last spring. The Council reached final decisions concerning proposals that will be made in its final report--now scheduled to be submitted formally by mid-February. Under the law the report must be sent to the Congress as well as to you.

The purpose of this memorandum is to alert you to the decisions and conclusions of the Council. We have already given you our general endorsement of one Council recommendation, that is for restructuring social security benefits to stabilize replacement rates. However, their major recommendation has attracted so much attention that I wanted you to have my personal opinion now. We will be giving you our appraisal of the other recommendations soon.

Unfortunately, the Council's recommendation on social security financing reached at the last minute in their deliberations, is most regrettable, in my opinion. They recommend that we no longer finance Medicare from payroll taxes, as at present, but that we use the Medicare portion of the existing payroll tax for Social Security benefits. Medicare (some \$14 billion) would be paid for out of general fund revenues. As proposed by the Council, this shift would occur gradually over several years as the need for additional revenues for the cash benefits program increases. This would be the first step in using the general fund to finance social security - Medicare benefits, and, in my opinion, would add to existing pressures to fund all social security from the general fund, thereby removing the discipline that now requires tax increases to match (reasonably closely) benefit increases.



Page 2

While under the Council's approach, no net increase in the payroll tax would be necessary for many years obviously we would have to add the Medicare costs to the already huge deficit, or increase general taxation.

The Council's recommendations are described briefly in the enclosed summary (Tab A). I am also attaching (Tab B) a memorandum I submitted to you on this subject after the Council's meeting in December. Much of that memorandum has obviously been overtaken by events; however, we would appreciate your guidance on the question of stabilizing replacement rates, Issue #2 on page 4.

/s/ Cap Weinberger

Secretary



Summary of Major Findings and Recommendations of the 1974 Advisory Council
on Social Security

A. Cash Benefits

1. Purpose and principles. The earnings-related OASDI program should be preserved as the Nation's primary means of providing economic security in the event of retirement, death, or disability. Future changes in OASDI should conform to the fundamental principles of the program: universal compulsory coverage, earnings-related benefits paid without a test of need, and contributions toward the cost of the program from covered workers and employers.
2. Benefit structure--replacement rates. The provisions of present law for computing average monthly earnings, on which benefits are based, and for adjusting the benefit table in the law to changes in prices may result over the long range in unintended, unpredictable variations in the level of benefits. The benefit structure should be revised to maintain the levels of benefits in relation to pre-retirement earnings levels that now prevail. Benefits for workers coming on the rolls in the future should be computed on the basis of a revised benefit formula using past earnings indexed to take account of changes during their working lives in the average earnings of all covered workers. As under present law, benefits for people on the rolls would continue to be increased as price levels increase.
3. Retirement test. The provisions of the present retirement test should be modified so that beneficiaries who work can retain more of their benefits. Instead of reducing benefits by one dollar for every two dollars of earnings above the exempt amount of earnings, as under present law, one dollar of benefits should be withheld for every three dollars of earnings between the exempt amount and twice the exempt amount, and one dollar for two dollars above that level. Also, the provision under which a full benefit may be paid for any month in which a beneficiary earns less than one-twelfth of the annual exempt amount should be eliminated, except for the first year of entitlement to benefits. The test should be based on annual earnings.*

* Latter proposal was included in the November 26, 1974, Presidential message on recommendations for reducing Federal outlays and is being resubmitted to the Congress with the 1976 Budget.

1/20/75

4. Treatment of men and women. The requirements for entitlement to dependents' and survivors' benefits that are now applied to women should be applied to men, and benefits should be provided for fathers and divorced men as they are for mothers and divorced women. At the same time, the law should be changed, effective prospectively, so that pensions based on one's work in employment not covered by social security will be subtracted from his social security dependents' benefits. Other provisions of the social security program which are the same for men and women but which are criticized because they appear to have different effects on men and women (or different effects based on marital status) should not be changed.
5. Other recommendations.
 - a. Universal compulsory coverage. Although social security coverage is nearly universal, the gaps in coverage that remain may result in unwarranted duplication of benefits. Social security coverage should be applicable to virtually all gainful employment. Ways should be developed to extend coverage to those areas of employment, especially public employment, for which coordinated coverage under social security and existing staff-retirement systems would assure that total benefits are reasonably related to a worker's lifetime earnings and contributions.
 - b. Minimum benefit. Partly because of the gaps in social security coverage, the minimum benefit is frequently a "windfall" benefit to those, such as Federal retirees, who are already receiving a pension based on earnings in employment not covered by social security. Almost all workers who have worked in social security employment with some regularity become entitled to higher than minimum social security benefits. The minimum benefit in present law should be frozen at its level at the time the new benefit structure recommended under number 2 above goes into effect and the new system should not pay benefits exceeding 100 percent of the indexed earnings on which the benefit is based.
 - c. Definition of disability. The definition of disability should be revised to provide reduced disability benefits for workers aged 55 or over who cannot qualify for benefits under present law but who are so disabled that they can no longer perform jobs for which they have considerable regular experience.

- d. Miscellaneous. Further study is needed on three matters: the effects of the social security program on different racial and ethnic groups, ways of simplifying the social security program and its administration, and the frequency of cost-of-living adjustments in benefits. In addition, a general study of social security by a full-time non-Government body is suggested.

B. Financing

1. Actuarial status. While the cash benefits program will have adequate funds to meet its obligations for the short range, additional short-range financing would be needed to maintain trust fund levels and to meet the cost of the Council's benefit recommendations. Over the 75-year valuation period, the program faces a serious deficit. Steps should be taken soon to assure the financial integrity and long-range financial soundness of the program.
2. Contribution rate.
 - a. Employee-employer: No increase should be made in the total contribution rates for employees and employers for cash benefits and hospital insurance. However, the OASDI contribution rate should be gradually increased, as OASDI costs increase, and the increases should be met by reallocating contributions now scheduled in the law for Part A (Hospital Insurance) of the Medicare program. Income lost to the Hospital Insurance program by this reallocation should be made up from the general funds of the Treasury.
 - b. Self-employed: The present 7-percent limitation on the contribution rate for the self-employed should be removed. The self-employment OASDI contribution rate should be the same multiple of the employee contribution rate as was fixed at the time the self-employed were first covered—150 percent.
3. Retirement age. The Council recognizes that under current demographic projections there will be a sharp rise in the number of people who have reached retirement age relative to the working age population in the first several decades of the next century. Although the Council is not now recommending an increase in the age of eligibility for social security retirement benefits in the next century, the Council does believe that such a change might merit consideration by the Congress in later years, when the burden on people still working may become excessive.

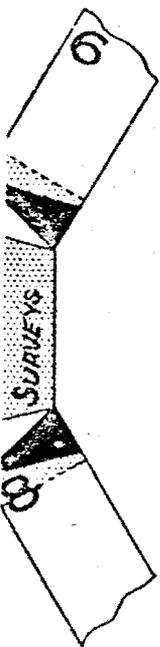
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December 23, 1974

MEMORANDUM FOR THE PRESIDENT

On December 11, we discussed social security problems and issues.

At the close of our meeting, I indicated that we would suggest appropriate language concerning social security for inclusion in the State of the Union Message. We have already transmitted such language under separate cover as a part of this Department's general proposals for the State of the Union Message. The language that we recommend (Tab A) concerning social security would indicate your awareness of the problems and issues facing social security and your intention to make specific proposals sufficient to maintain the future financial integrity of the system--as soon as you have had an opportunity to consider the conclusions and recommendations of the 1975 Advisory Council on Social Security, which is expected to finish its work in late January or early February. The language deliberately avoids any commitment to a specific course of action at this time on the assumption that specific recommendations should await receipt of the Advisory Council report.

At the close of our December 11 meeting, I also indicated that I would submit action proposals on each of the social security issues that we discussed. Since that meeting, the Advisory Council has had another session and is now considering several new proposals affecting financing that were not anticipated when we met with you. They have also moved a step closer to recommendations that would liberalize several features of the existing program. These liberalizations, if adopted, would increase the cost of the program for both the short and long term.

Perhaps the most significant proposal now being considered is one that would increase the retirement age beginning in the 21st century. This is being reviewed by the Council as one means of reducing the long-term costs of the program and thereby limiting future tax requirements. The Council is also debating some rather rapid and early increases in the so-called wage base (the maximum amount of earnings taxable for a worker). An early increase in the wage base would produce new revenues and might facilitate postponement of tax rate changes in the near term.

Adoption by the Council of any or all of these new considerations could have a significant effect on the design and timing of tax and other financing proposals--including any that the Administration might want to consider.

Given these developments, I believe we need to know more about the Council's final conclusions before the Administration makes its own decisions and choices. We should know precisely what the Council will finally recommend by around mid-January. This would still give us adequate time to make decisions and to draft legislative proposals, to the extent needed, for early submission to Congress.

Therefore, it is my recommendation that two matters be decided at this time and that decisions on all other items be deferred until we know more about the Council's final recommendations. The two decisions that I believe to be necessary at this time are:

1. A decision as to whether to include language in the State of the Union Message--which we would urge you to do. I gather that this has all but been decided and that all that remains is selection of the language itself.
2. A decision as to whether you want to adopt, in principle at least, the idea of stabilizing replacement rates. In this case, we already know that the Advisory Council will recommend stabilization of replacement rates.

Although a great deal of work has already been done on a rate stabilization proposal, consideration of alternative approaches and the design of a final legislative package will take some time. For this reason, we believe it would be wise to make a basic decision now.

It is our belief that the replacement rate criteria that have been adopted by the Advisory Council would provide a sound basis for any Administration replacement rate proposal. The criteria being followed by the Advisory Council are:

1. The new formula should be constructed so as to neither increase nor decrease, on the average, current benefit levels.
2. The new formula should be constructed so as to continue weighted benefits for low-income workers.
3. Criteria 1 and 2 would result in stabilized replacement rates of about 60 percent for low-income workers, about 40 percent for median-income workers, and about 30 percent for higher-income workers.

4. A transition period should be provided during which no worker would be disadvantaged at the time of his retirement by reason of the new formula.

In deciding the question of whether or not to proceed with development of an Administration proposal to stabilize replacement rates based on the above criteria, you should consider the following pros and cons:

Pro

1. Stabilized replacement rates would result in a more rational social security system. In other words, future benefits would be based on public policy decisions as to how much of a person's earnings should be replaced rather than on the happenstance of future shifts in wages, prices, and productivity.
2. Stabilization should improve public understanding of what a worker earns for his tax contribution.
3. Under currently predicted economic circumstances (or under any economic circumstance in which inflation occurs or in which productivity falls), a decision to stabilize has the advantage of significantly reducing long-term costs. In turn, future tax rates would not have to be as high as otherwise predicted. Rate stabilization should reduce the ultimate tax rate as applied to the individual by 1 to 2 percent.
4. All actuaries and economists who have been consulted on this matter, whether by the Advisory Council, the Social Security Administration, or the Congress, have supported stabilization of replacement rates. Any proposal to do so should receive strong support from professionals in these fields.

Con

1. Because future benefits would not rise as much as under current law, some are apt to oppose it. Organized labor might oppose such a proposal for this reason. (At this writing, labor representatives on the Advisory Council have tentatively voted for it.)



2. Such a change could, perhaps, provoke a debate about the adequacy of existing replacement rates. (Times being what they are, we doubt that this argument would prevail.)
3. Some might accuse us of making this proposal for purely fiscal reasons and at the expense of lower future benefits.

A further discussion of the replacement rate issue is enclosed under Tab B.

Recommendations

We recommend that:

1. Language concerning social security be included in the State of the Union Message.
2. That a Presidential decision be made now to proceed with development of a specific plan for replacement rate stabilization that would become an early Administration initiative.
3. That, with the exception of the replacement rate stabilization issue, Presidential decisions concerning what to do about other social security issues, including the question of tax changes, be held in abeyance until about mid-January or as soon as we know with greater certainty what the Advisory Council will recommend on these issues. (At that time, we would provide you with a set of action choices on each of the items.)

Decisions

1. Include social security as topic in State of the Union Message.
 Approved _____ Disapproved _____ Other _____
2. Proceed with immediate preparation of replacement rate stabilization legislative proposal for my later review and approval.
 Approved _____ Disapproved _____ Other _____



3. Defer other social security issues until Advisory Council recommendations become final (mid-January) and present specific decision proposals at that time.

Approved _____ Disapproved _____ Other _____

/s/ Caspar W. Weinberger
Secretary

Enclosures



DRAFT SOCIAL SECURITY LANGUAGE FOR
STATE OF THE UNION MESSAGE

This year marks the 40th anniversary of social security. Today, almost every American family is protected by the program, and one out of every seven Americans is currently receiving social security benefits. In recent years, great strides have been made in upgrading benefit levels and assuring adequate benefits for the future. Our concern now must be to insure that social security is adequately financed for the future. The system's financing and a number of other social security issues have been under study by this Administration and the current Advisory Council on Social Security. The Advisory Council is now preparing its final report. After I have an opportunity to consider the Council's conclusions, I will present to the Congress my own recommendations for insuring the future adequacy of the social security system.



PROPOSAL TO STABILIZE SOCIAL SECURITY REPLACEMENT RATES

The most meaningful way to measure the effect of social security is to look at replacement rates--the share of a worker's most recent earnings that is replaced by his retirement or disability benefit.

Current law results in replacement rates with two characteristics:

1. They are weighted in favor of lower-income workers. This is the result of a deliberate public policy choice, adopted because low wage earners have less margin for reduction in their income due to retirement or disability.
2. They are not stable or fixed for the future. They can change dramatically, depending on what happens to the economy. This clouds public understanding and does not reflect any deliberate public policy choice.

Current Replacement Rates

Today, social security retirement benefits replace about 62 percent of the most recent earnings of a person with an income of \$3,200. For a person earning about \$7,700 per year (the median earnings), the current replacement rate is about 44 percent. In the case of a person earning \$13,200 per year (the maximum earnings base against which the tax is assessed), the replacement rate is about 30 percent.

The latest long-range forecasts show, beginning in about 1995, that replacement rates will start to rise sharply. They will reach about 75 percent for the low-income worker at the turn of the next century and will exceed 85 percent by the year 2040. In some cases, it will even be possible for benefits to replace significantly more than 100 percent of an individual's most recent earnings. (This would be true only for low wage earners.) Although replacement rates will not rise as sharply for median earners and maximum earners, unplanned increases are also predicted for these groups.

Effect of "Double Indexing" Under Present Law

Because the cost-of-living indexing system now in the law is driven by changes in both wages and prices, replacement rates will always rise whenever both wages and prices rise over a



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Effect of "Double Indexing" Under Present Law

Because the cost-of-living indexing system now in the law is driven by changes in both wages and prices, replacement rates will always rise whenever both wages and prices rise over a



prolonged period or productivity declines significantly. If future benefit amounts for current workers were geared solely to changes in wage levels rather than to both wages and prices, as under present law, replacement rates would be stabilized and long-term program costs would not increase to the extent now estimated. Under this concept, cost-of-living increases based on price rises would affect benefits only after a person came onto the benefit rolls. In other words, under a stabilized system, the benefit a current worker would receive when he retired would increase based on increases in his wages, and after retirement it would be kept up to date with the cost of living.

If the benefit formula were changed so as to stabilize replacement rates at current levels, long-term costs to the system could be reduced. The Advisory Council has developed a rate stabilization formula that would (1) stabilize replacement rates at about current levels, (2) continue the existing weighting in the benefit formula, (3) assure that the average worker would suffer no loss in benefits during the period of transition from the old formula to the new formula, and (4) result in about a one-third reduction in the long-term actuarial deficit.

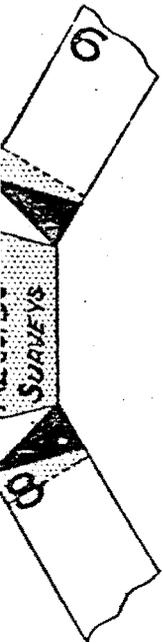


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NOTE:

This memorandum was prepared on the assumption that the automatic benefit increase for 1975 would be 8.1 percent rather than 8.0 percent as determined by recent CPI changes. All other assumptions are still valid. The actual dollar figures relating to the progress of the trust funds will change very slightly as a result of the lower benefit increase.

4/23/75



MEMORANDUM

March 31, 1975

FROM: Lawrence Alpern

IAC-1

SUBJECT: Operations of the OASI and DI Trust Funds Under Present Law, on the Basis of Two Sets of Economic Assumptions, Calendar Years 1974-80

Estimates of the operations of the old-age and survivors insurance (OASI) and disability insurance (DI) trust funds under present law in calendar years 1975-80 have been completed. The presentation of such estimates necessarily calls for full recognition of the difficulties of estimating the income and expenditures of a system that is highly sensitive to economic change. This is particularly true today because of the uncertainty of future economic developments.

One set of estimates was prepared on the basis of the economic assumptions set forth on page 41 of the President's 1976 Budget. Since significant changes in economic trends have taken place after those assumptions were prepared (e.g., a lower level of economic activity, a somewhat slower rate of increase in the CPI, higher rates of unemployment), a second set of economic assumptions was just completed in SSA for use in preparing an updated set of estimates.

The results of the two sets of estimates are summarized in the table shown at Tab A. The economic assumptions underlying the two sets of estimates, together with a brief narrative statement relating to the SSA assumptions, are shown at Tab B.

The future path of the CPI and future increases in average annual wages in covered employment are different for the two sets of assumptions, as shown in the following table.

Calendar year	Increase over prior year in annual average- Wages under-		CPI under-	
	1976 Budget assumptions	SSA assumptions	1976 Budget assumptions	SSA assumptions
1975	7.0%	6.2%	11.3%	9.0%
1976	9.8	9.0	7.8	6.6
1977	10.5	11.0	6.6	6.5
1978	9.2	8.8	5.2	5.7
1979	8.0	7.7	4.1	4.6
1980	7.9	7.0	4.0	4.0

The automatic increase provisions enacted in 1972 affect both future income and future expenditures of the OASDI system. The estimates presented herein reflect the following changes assumed to occur, under the automatic increase provisions, in each year 1975-80 (actual amounts for 1974, together with the already-established contribution and benefit base for 1975, are also shown, as a basis for comparison):

Calendar year	General benefit increase for June, under-		Contribution and benefit base on January 1, under-	
	1976 Budget assumptions	SSA assumptions	1976 Budget assumptions	SSA assumptions
1974	11.0%	11.0%	\$13,200	\$13,200
1975	8.7	8.1	14,100	14,100
1976	9.2	6.6	15,300	15,000
1977	6.9	6.4	16,800	16,500
1978	5.7	6.3	18,600	18,300
1979	4.4	4.8	20,400	19,800
1980	4.0	4.0	21,900	21,300

Lawrence Alpern
 Lawrence Alpern
 Deputy Chief Actuary

Enclosures



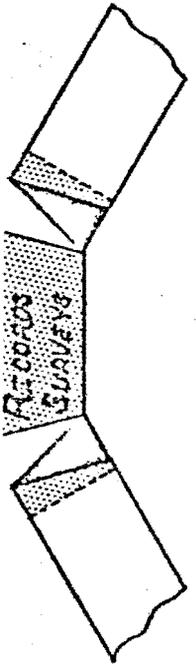
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Estimated operations of the old-age and survivors insurance (OASI) and disability insurance (DI) trust funds under present law, on the basis of two sets of economic assumptions, calendar years 1974-80

(Amounts in billions)

Calendar year	Income		Outgo		Net increase in funds		Assets at end of year		Assets at beginning of year as a percentage of outgo during year	
	1976 Budget assumptions	SSA assumptions	1976 Budget assumptions	SSA assumptions						
<u>OASI and DI trust funds, combined</u>										
74	\$62.1	\$62.1	\$60.6	\$60.6	\$1.5	\$1.5	\$45.9	\$45.9	73%	73%
75	67.4	66.5	69.8	69.6	-2.3	-3.0	43.6	42.9	66	66
76	73.6	72.3	79.7	78.2	-6.1	-5.9	37.5	37.0	55	55
77	82.2	81.8	90.5	87.6	-8.3	-5.9	29.2	31.1	41	42
78	91.3	91.1	100.4	97.2	-9.1	-6.1	20.1	25.1	29	32
79	100.6	100.3	110.2	107.2	-9.5	-6.9	<u>1/</u> 10.6	18.2	18	23
80	110.2	109.1	119.9	116.9	-9.6	-7.8	<u>1/</u> 0.9	<u>1/</u> 10.4	9	16
<u>OASI trust fund</u>										
74	\$54.7	\$54.7	\$53.4	\$53.4	\$1.3	\$1.3	\$37.8	\$37.8	68%	68%
75	59.4	58.6	61.0	60.8	-1.6	-2.2	36.2	35.6	62	62
76	64.9	63.8	69.5	68.1	-4.6	-4.4	31.6	31.2	52	52
77	72.5	72.2	78.8	76.3	-6.2	-4.1	25.4	27.1	40	41
78	80.3	80.1	87.2	84.5	-7.0	-4.4	18.4	22.7	29	32
79	88.5	88.2	95.7	93.1	-7.2	-4.9	11.2	17.8	19	24
80	97.0	96.0	104.0	101.4	-7.0	-5.5	4.1	12.3	11	18
<u>DI trust fund</u>										
74	\$7.4	\$7.4	\$7.2	\$7.2	\$0.2	\$0.2	\$8.1	\$8.1	110%	110%
75	8.0	7.9	8.8	8.8	-0.7	-0.8	7.4	7.3	92	93
76	8.7	8.6	10.2	10.1	-1.5	-1.5	5.8	5.8	72	72
77	9.7	9.6	11.7	11.4	-2.1	-1.8	3.8	4.0	50	51
78	11.1	11.0	13.1	12.7	-2.1	-1.7	1.7	2.3	29	32
79	12.2	12.1	14.5	14.1	-2.3	-2.0	-0.6	0.4	12	17
80	13.2	13.1	15.8	15.4	-2.6	-2.3	-3.2	-2.0	-4	2

trust fund exhausted in 1979 under 1976 Budget assumptions and in 1980 under SSA assumptions; reflects "borrowing" from OASI trust fund.

Selected Numerical Values Under Two Sets of Economic Assumptions, 1975-80

	Calendar years; dollar amounts in billions					
	1975	1976	1977	1978	1979	1980
Gross national product						
Current dollars						
Amount						
Budget (1976).....	\$1,498	\$1,686	\$1,696	\$2,123	\$2,353	\$2,606
Social Security Administration (SSA).....	1,477	1,671	1,912	2,147	2,380	2,615
Percent change						
Budget.....	7.2	12.6	12.4	12.0	10.8	10.8
SSA.....	5.7	13.1	14.4	12.3	10.9	9.9
Constant dollars						
Amount						
Budget.....	\$794	\$832	\$879	\$936	\$997	\$1,061
SSA.....	787	837	898	958	1,020	1,078
Percent change						
Budget.....	-3.3	4.8	5.6	6.5	6.5	6.5
SSA.....	-4.1	6.4	7.3	6.7	6.5	5.7
Wages and salaries						
Budget.....	\$792	\$884	\$999	\$1,117	\$1,236	\$1,367
SSA.....	780	873	998	1,115	1,232	1,346
Prices (percent change)						
GNP deflator						
Budget.....	10.8	7.5	6.5	5.1	4.1	4.0
SSA.....	10.3	6.4	6.7	5.3	4.1	4.0
Consumer Price Index						
Budget.....	11.3	7.8	6.6	5.2	4.1	4.0
SSA.....	9.0	6.6	6.5	5.7	4.6	4.0
Unemployment rate (percent)						
Budget.....	8.1	7.9	7.5	6.9	6.2	5.5
SSA.....	8.8	8.0	7.0	6.2	5.4	4.8
Addendum:						
Automatic benefit increase for June (percent)						
Budget.....	8.7	9.2	6.9	5.7	4.4	4.0
SSA.....	8.1	6.6	6.4	6.3	4.8	4.0

Social Security Administration
March 31, 1975



SSA ECONOMIC ASSUMPTIONS

The path of prices, wages, and employment between 1975 and 1980 assumed by SSA is intended to reflect the following factors:

1. a lower level of economic activity in 1975 than was assumed in the 1976 Budget.
2. delay in implementation and uncertainty over the final form of an energy program.
3. a somewhat slower rate of increase in the CPI in 1975-76 than the Budget assumptions contain.
4. a more stimulative economic environment, which results in more rapid economic growth in 1976-78 than was assumed in the Budget.
5. failure of output per manhour to recover fully recent short-falls from its trend rate of growth, thus lowering projected constant dollar GNP at full employment (potential GNP) below that assumed in the Budget projections in 1977-80.

The SSA set of assumptions yields a lower current dollar GNP in both 1975 and 1976 than the Budget assumptions. This is due to the assumed lower rate of increase in prices and to the assumed delay in fully implementing any energy program until the end of 1977. Current dollar GNP is higher than the Budget assumptions in 1977-80, despite a somewhat lower GNP deflator, reflecting the higher level of constant dollar GNP in the alternative assumptions throughout that period.

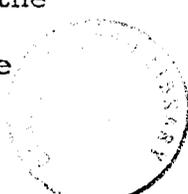
Constant dollar GNP is lower in the alternative assumption only in 1975. The higher level of constant dollar GNP in 1976-80 is attributable to a more stimulative fiscal environment which is assumed in the alternative.



The largest differences in constant dollar GNP growth rates between the Budget and the SSA assumptions occur in 1976 and 1977. As a result, constant dollar GNP is 2.4 percent higher in 1978 in the alternative assumptions than in the Budget assumptions.

The unemployment rate averages 8.8 percent in 1975 in the alternative assumptions compared to 8.1 percent in the Budget assumptions. This reflects the more rapid decline in economic activity assumed in the alternative in the near term. The more stimulative policy embodied in the alternative causes the unemployment rate to fall below the unemployment rate projected in the Budget, starting in 1977. The trend rate of unemployment is assumed to be $4\frac{3}{4}$ percent, which is reached in 1980.

Percentage increases in the CPI between the first quarter of each year (the relevant measure for social security benefit increases) are lower in 1975-77 in the SSA assumptions. The indicated automatic social security benefit increase effective in 1975 is reduced from 8.7 percent (Budget) to 8.1 percent. It is assumed that the recent favorable price behavior will continue. The delay that has been assumed in the implementation of an energy program contributes to the reduction in the 1976 benefit increase (compared with the Budget assumptions). It is assumed that the total impact of an energy program on the CPI will be to raise the CPI by 2 percent, with the full effect being felt by the end of 1977. The delay, along with the generally lower rates of price increase contained in the alternative, reduces the 1976 benefit increase by 2.6 percentage points, while the lower rates of price increase reduce the 1977 benefit increase by 0.5 percentage point. Because some of the



increase in the CPI attributable to the energy program has been delayed until after the first quarter of 1977, the CPI increase in the alternative for 1978 is 0.6 percentage point higher.

Wages and salaries are lower than the Budget assumptions in 1975, because of the lower levels of economic activity and average wages assumed by SSA. The lower average wages in the alternative produce lower wages and salaries in 1976-80, despite higher levels of economic activity assumed for those years. The increase in wages and salaries after 1975 is not as large as might be expected from the fiscal stimulus assumed in the alternative. This occurs because the alternative projections assume that part of the less-than-trend increases in productivity of recent years will not be recouped, thus reducing real earnings gains, and that the historically observed faster rate of growth in nonwage compensation as compared with wages and salaries will retard growth in total wages. Hence, contribution income, which is closely linked with total wages and salaries, will be relatively unchanged between the two sets of assumptions over the entire period 1975-80 even though higher levels of economic activity are assumed by SSA starting in 1976.

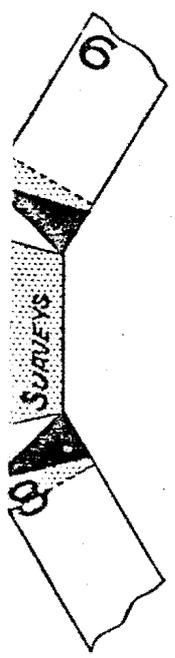
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Social Security Legislative and Administrative Proposals
in FY '76 Budget

OASDI and SSI

Legislative Proposals:

1. Limit to 5 percent the amount of the automatic social security and SSI benefit increases scheduled to be paid in July 1975.
2. Eliminate retroactivity of social security benefit applications where permanently reduced benefits would result.
3. Tighten and simplify the retirement test by eliminating the monthly test of retirement except for the first year for which benefits are paid.

Administrative Proposals:

None

Medicare

Legislative Proposals:

1. Impose a hospital insurance (part A) coinsurance amount equal to 10 percent of charges above the \$92 deductible amount.
2. Increase the supplementary medical insurance (part B) deductible automatically in proportion to the increase in cash benefits. Current deductible is \$60.
3. Impose an annual cost-sharing liability limit under parts A and B each of \$750 increased in the future in proportion to increases in cash benefits.
4. Authorize the Secretary to establish percentage limits on the rate of increase in incurred costs recognized as reasonable in determining provider reimbursements.
5. Unfreeze the SMI premium.

Administrative Proposals:

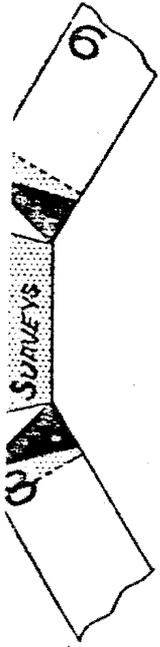
1. Conduct utilization review concurrent with a patient's admission.
2. Set upper limits on the amounts which Medicare will recognize as reasonable and will reimburse to hospitals. The current limit, which is set at the 90th percentile, will be reduced so that no routine costs above what the majority of hospitals incurred in payment will be automatically recognized as reasonable.
3. Limit Medicare reimbursement for drugs to the cost of less expensive generic equivalents if they are available.
4. Reduce the balances held by banks that service Medicare intermediaries.
5. Eliminate the allowance for higher than average nursing cost for Medicare patients. At present Medicare reimburses hospitals 8.5 percent more for routine nursing care for aged beneficiaries than for other patients.

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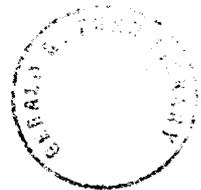
EFFECT OF COST-CONTROL PROPOSALS

While it is virtually certain that the Administration's cost-control legislation will not be enacted, it is useful to understand the specific effect of these proposals. The effect on the trust funds, if the proposed social security cost-reduction legislation were enacted, is illustrated in the attached table using presently scheduled taxes. It should be noted that an effective date of January 1, 1976, has been assumed for that portion of the cost-reduction legislation carrying a budgeted effective date of March 1, 1975. The 5-percent limit on the July 1975 benefit increase cannot, of course, be delayed. (It would have to be enacted by late April or early May in order to be reflected in the July benefit payment.)

Enactment of the cost-control proposals would so substantially improve the financial status of the program that, with some reallocation of income from Medicare to OASDI, the tax rate increase now scheduled for 1978 could be reduced. The attached table also compares the tax rates scheduled under present law with those that would be sufficient to adequately finance both OASDI and Medicare if the cost-control legislation were enacted.

This specific alternative tax rate schedule permits a large reallocation of Medicare income beginning in 1976 only because of a major and almost immediate reduction in Medicare outlays resulting from the cost-sharing proposals. Since these proposals would not affect CHIP, however, the Medicare tax rates shown in the attached table, although adequate to finance the Medicare program, would not adequately finance CHIP.

Attachment



Option Assuming Enactment of Cost-Control Legislation

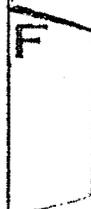
	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Tax rates for employer and employee, each</u>					
Present law					
OASDI	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare	0.90	0.90	1.10	1.10	1.10
Total	5.85	5.85	6.05	6.05	6.05
Cost-Control Option					
OASDI	4.95	5.05	5.20	5.20	5.20
Medicare	0.80	0.80	0.85	0.85	0.85
Total	5.75	5.85	6.05	6.05	6.05
<u>Earnings base</u>					
Present law and Cost-control option	\$15,000	\$16,500	\$18,300	\$19,800	\$21,300
<u>Income minus outgo (in billions)</u>					
OASDI					
Present law	-\$5.8	-\$5.8	-\$6.0	-\$6.8	-\$7.7
Cost-control option	- 1.5	- 0.6	2.6	3.4	3.9
Medicare					
Present law	\$0.4	\$0.9	\$3.7	\$3.9	\$3.4
Cost-control option	0.3	1.1	1.4	0.9	0.3
<u>Reserve at beginning of year as a percentage of outgo during year</u>					
OASDI					
Present law	55%	42%	32%	24%	16%
Cost-control option	58	50	45	43	43
Medicare					
Present law	82	73	69	79	86
Cost-control option	90	83	79	77	73

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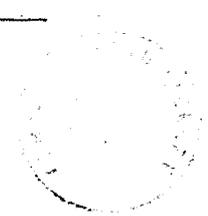
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Effect of Tax Only Option

	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Tax rates for employer and employee, each</u>					
Present law					
OASDI	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare	0.90	0.90	1.10	1.10	1.10
Total	5.85	5.85	6.05	6.05	6.05
Tax Only Option					
OASDI	4.95	5.30	5.40	5.40	5.40
Medicare	0.90	0.90	1.00	1.00	1.00
Total	5.85	6.20	6.40	6.40	6.40
<u>Earnings base</u>					
Present law and Tax Only Option	\$15,000	\$16,500	\$18,300	\$19,200	\$21,300
<u>Income minus outgo (in billions)</u>					
OASDI					
Present law	-\$5.8	-\$5.8	-\$6.0	-\$6.8	-\$7.7
Tax Only Option	- 5.8	- 0.5	2.4	3.2	3.8
Medicare					
Present law	0.4	0.9	3.7	3.9	3.4
Tax Only Option	0.4	1.0	2.0	1.7	0.9
CHIP (Tax Only Option)*		- 0.5	1.1	1.2	0.2
<u>Reserve at beginning of year as a percentage of outgo during year</u>					
OASDI					
Present law	55%	42%	32%	24%	16%
Tax Only Option	55	42	38	36	36
Medicare					
Present law	82	73	69	79	86
Tax Only Option	82	73	69	71	70
CHIP (Tax Only Option)*		56	48	46	45

* Assumes effective date for CHIP of 1/1/77.



Effect of Base/Tax Option A

	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Tax rates for employer and employee, each</u>					
Present law					
OASDI	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare	0.90	0.90	1.10	1.10	1.10
Total	5.85	5.85	6.05	6.05	6.05
Option A					
OASDI	4.95%	4.95%	5.30%	5.30%	5.30%
Medicare	0.90	0.90	1.00	1.00	1.00
Total	5.85	5.85	6.30	6.30	6.30
<u>Earnings base</u>					
Present law	\$15,000	\$16,500	\$18,300	\$19,800	\$21,300
Option A	15,000	18,000	20,700	22,500	24,300
<u>Income minus outgo (in billions)</u>					
OASDI					
Present law	-\$5.8	-\$5.8	-\$6.0	-\$6.8	-\$7.7
Option A	- 5.8	- 4.2	3.0	4.5	5.3
Medicare					
Present law	\$0.4	\$0.9	\$3.7	\$3.9	\$3.4
Option A	0.4	1.3	2.5	2.4	1.7
CHIP (Option A)*		-\$0.2	\$1.7	\$1.9	\$1.1
<u>Reserve at beginning of year as a percentage of outgo during year</u>					
OASDI					
Present law	55%	42%	32%	24%	16%
Option A	55	42	34	34	35
Medicare					
Present law	82%	73%	69%	79%	86%
Option A	82	73	71	75	76
CHIP (Option A)*		56%	49%	49%	50%

* Assumes effective date for CHIP of 1/1/77.

Effect of Base/Tax Option B

	Calendar Year				
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>
<u>Tax rates for employer and employee, each</u>					
Present law					
OASDI	4.95%	4.95%	4.95%	4.95%	4.95%
Medicare	0.90	0.90	1.10	1.10	1.10
Total	5.85	5.85	6.05	6.05	6.05
Option B					
OASDI	4.95%	4.95%	5.10%	5.10%	5.10%
Medicare	0.90	0.90	0.95	0.95	0.95
Total	5.85	5.85	6.05	6.05	6.05
<u>Earnings base</u>					
Present law	\$15,000	\$16,500	\$18,300	\$19,800	\$21,300
Option B	15,000	21,000	24,000	26,100	28,200
<u>Income minus outgo (in billions)</u>					
OASDI					
Present law	-\$5.8	-\$5.8	-\$6.0	-\$6.8	-\$7.7
Option B	- 5.8	- 2.0	2.5	3.5	4.1
Medicare					
Present law	\$0.4	\$0.9	\$3.7	\$3.9	\$3.4
Option B	0.4	1.7	2.2	1.9	1.2
CHIP (Option B)*		\$0.2	\$1.3	\$1.3	\$0.6
<u>Reserve at beginning of year as a percentage of outgo during year</u>					
OASDI					
Present law	55%	42%	32%	24%	16%
Option B	55	42	36	35	35
Medicare					
Present law	82%	73%	69%	79%	86%
Option B	82	73	73	75	75
CHIP (Option B)*		56%	50%	49%	48%

* Assumes effective date for CHIP of 1/1/77.

