

Social Insurance and Retirement Overview

Social insurance and retirement programs are the largest single group of domestic programs. They include social security, medicare, Federal retirement, unemployment insurance, railroad retirement, black lung, and the Pension Benefit Guaranty Corporation. In general they are financed by dedicated revenues, chiefly payroll taxes, which gives them their "insurance" character. Until recently they were also the fastest growing group in the Federal budget. Twenty years ago social insurance and retirement programs were 39% of all domestic programmatic outlays; they are now 57% of the domestic budget. The growth in these programs has gone through two distinct phases:

- An era of *bipartisan legislative expansion* between 1962 and 1977; and
- An era of *bipartisan legislative restraint* between 1977 and the present.

The era of expansion resulted in real growth rates over 1962-1981 of 8.7%. In real terms, 1981 outlays were almost *five times higher* than the comparable level for social insurance and retirement programs in 1962.

The dramatic increase in social insurance and retirement programs has abated since 1980. As a result of social security reforms adopted in 1977, 1980 and 1983, and medicare, unemployment compensation, and railroad retirement reforms adopted in the same time period, the real current services growth rate for social insurance programs will decrease to 3.4% over the 1981 to 1986 period. By 1989, the solvency gap in the social insurance budget as a whole will be nearly closed. This period of rapid expansion, followed by an era of restraint, is graphically illustrated in the following chart.

Era of Legislative Expansion

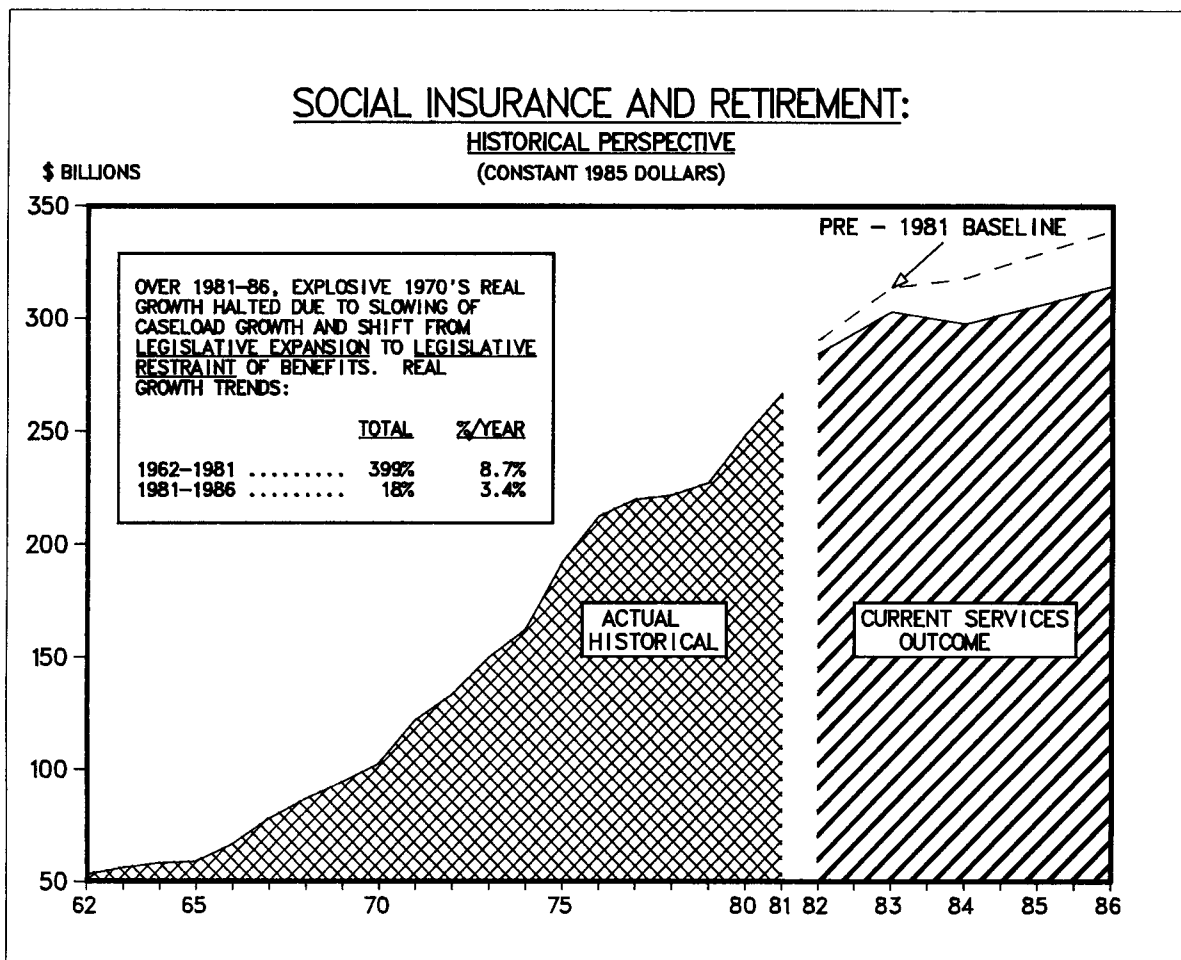
The growth in outlays for social insurance and pension programs between 1962 and 1981 was faster than any other category of the Federal budget. It translated into an increase in the share of GNP for social insurance and retirement programs from 2.9% in 1962 to 7.6% in 1981, accounting for more than the entire increase in the ratio of Federal spending to GNP during these 19 years. The peak share was reached in 1983 at 8.6%.

Social Insurance and Retirement Growth

(In billions of constant 1985 dollars)

	Actual					Current services	
	1962	1965	1970	1975	1981	1985	1989
Medicare.....	....	....	15.3	23.6	46.3	69.1	92.4
Social security.....	46.8	54.2	77.6	126.0	168.5	188.3	209.4
Federal retirement ¹	-7.4	-5.2	-0.8	12.1	24.8	24.3	28.0
Unemployment insurance.....	11.7	8.1	8.1	24.7	20.6	18.3	12.7
Other.....	2.2	2.1	2.7	5.8	6.6	5.9	5.7
Total, social insurance and retirement.....	53.4	59.2	102.8	192.3	266.8	305.8	348.1
Annual average growth rate (from prior period).....	N/A	3.5	11.7	13.3	5.4	3.5	3.3
As a share of domestic budget.....	39.2	38.6	43.0	46.7	50.7	57.5	62.3
As a share of GNP.....	2.9	2.8	4.1	6.7	7.6	7.9	7.7

¹ Federal retirement includes the employer contribution for military retirement. The contribution is on an accrual basis, i.e., the annual cost of the future retirement for the present employees. The contributions are treated as negative outlays and more than offset the Federal retirement benefit outlays in the early years.



The real growth in these program can be attributed to both increases in the number of beneficiaries and increases in the level of real benefits distributed.

- *Increases in beneficiaries.*—From 1962 to 1981 the number of beneficiaries of existing programs doubled because of the legislation expanding the definition of eligibility and caseload growth relating to the general aging of the population. Approximately three-fourths of the beneficiaries of these programs are aged, a group who increased 55% in numbers between 1962 and 1981. In addition, medicare was introduced in 1966 and by 1981 its beneficiaries had grown to 7.2 million for hospital insurance and 28.6 million for supplementary medical insurance.
- *Increases in real benefits.*—These increases result from excessive cost-of-living adjustments (COLAs), increases in wage histories on which initial retirement benefits are based, and legislative expansions of both benefits and services such as adding physical therapy and home health services to medicare.

The causes of real growth differ among the programs. For social security and medicare, the growth in average real benefits was even more important than the substantial growth in beneficiaries. However, for Federal retirement programs and unemployment insurance, the growth in beneficiaries was much more important than increases in real benefits.

Overindexation of retirement benefits.—Average real benefits in all the retirement programs grew substantially in the 1970's, partly because of legislative increases, but also because they were overindexed. The cost-of-living index that was used to adjust Federal social insurance benefits, the Consumer Price Index, overcompensated for the rising costs of home mortgages and therefore overstated the rise in the actual cost-of-living the average Federal beneficiary faced. Since a more accurate measure of consumer prices was not available when the first automatic cost-of-living adjustments were made in social security in 1975, the CPI was used and the average benefit was about 6% larger than it should have been by 1981.

Between 1970 and 1975, Federal retirees also received a 1% COLA kicker every time their benefits were adjusted. Before this provision was changed, it provided Federal retirees an additional windfall in their benefits from 1970 to 1975 of more than 5%. In addition, between 1976 and the 1981 reforms, benefits were indexed twice a year. The combined effect of these COLA provisions was to give retirees increases in their benefits that exceeded the increases in average wages for the working population. This trend was particularly troublesome for Federal employees, where retirees' compensation rose faster than that of the active employees. Thus the employee who retired in 1970 receives an annuity today that is 27-34% more than the annuity of an employee who retires this year at the same grade and step.

Underindexation of medicare copayments.—At the same time that retirement benefits were overindexed, medicare deductibles and premiums were underindexed. For example, between 1970 and 1981, the supplementary medical insurance (SMI) deductible rose from \$50 to \$75, a yearly growth rate of 3.7%. If the medical component of the CPI had been used to index the deductible each year, the deductible in 1981 would have been about \$120, 60% greater than it actually was. Likewise, in 1970, the SMI premium paid by beneficiaries was set at 50% of program costs. By 1981, the beneficiaries' contribution has decreased to 25% of program costs.

Dedicated trust fund financing principle.—The overindexation of retirement benefits and the underindexation of medicare copayments exacerbated the fiscal deterioration of the social insurance and retirement trust funds. Between 1979 and 1983, the balance between current cash outlays and dedicated trust fund receipts steadily worsened under the combined pressure of overindexed benefits, high unemployment, stagnant real wages and the underindexing of medicare copayments. The steady improvement after 1983 in the solvency of the trust funds projected under both current law and the 1985 budget reflects the cumulative and growing effects of solvency reform and benefit restraint legislation adopted beginning in 1977. This deteriorating trend and its reversal is illustrated in the accompanying table.

Social Insurance and Pension Trust Fund Solvency ¹

(Dollars in billions, actual through 1983 and current services thereafter)

	Outlays	Receipts	Deficit	Receipts as a percent of outlays
1979	154.7	138.9	—15.8	90%
1980	183.5	157.8	—25.7	86%
1981	216.1	182.7	—33.4	85%
1982	246.8	201.5	—45.3	82%
1983	276.2	209.0	—67.3	76%
1984	283.5	239.5	—44.1	84%
1985	305.5	269.0	—36.5	88%
1986	328.4	294.6	—33.8	90%
1987	354.0	320.3	—33.7	90%
1988	380.2	357.7	—22.5	94%
1989	408.2	389.5	—18.6	95%

¹ Includes medicare, social security, unemployment insurance, Federal civil service retirement and railroad retirement.

Era of Bipartisan Restraint

Since 1977, a bipartisan recognition has emerged that social insurance programs were rapidly becoming unaffordable and insolvent. A consensus about how to control the growth of social insurance and pension programs developed based on the following principles:

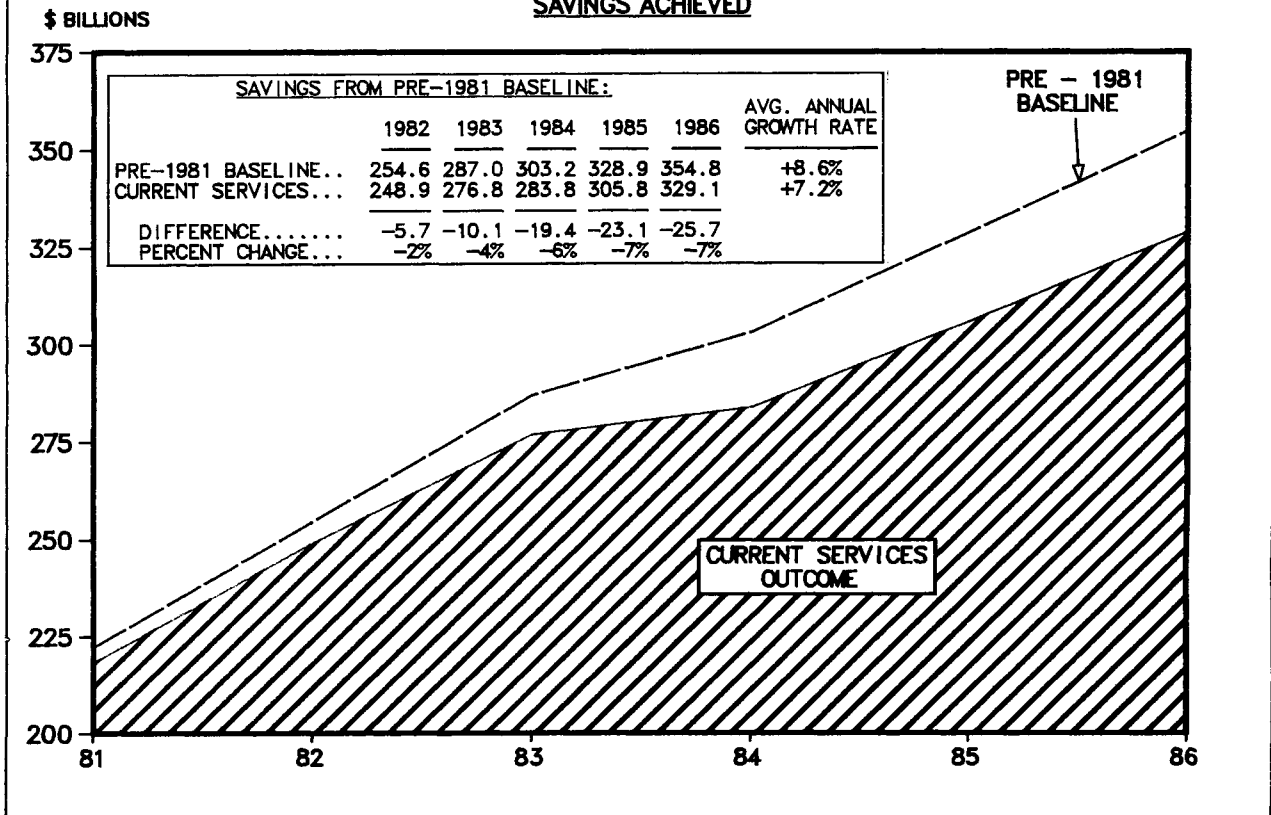
- A commitment to maintaining the basic structure of universal protections against the risks of unemployment, retirement, old age, sickness, and disability that emerged over the four decades prior to 1980;
- Recognition that benefit liberalizations, coverage expansions and ad hoc payment increases granted during the 1960's and 1970's had produced unsustainable growth momentum that had to be checked firmly;
- Rejection of massive annual general fund subsidies as a means of halting the deteriorating financial condition of various social insurance trust funds in favor of "solvency plans" that reinforce the essential social insurance character of these programs; and
- Solvency reform formulas based on a "shared responsibility" principle that has included fiscally responsible increases in trust fund contributions and a slowdown in the growth of benefits, thus steadily reversing the massive funding shortfalls that emerged in the late 1970's and early 1980's.

The legislative improvements began with the 1977 Social Security Act, which raised scheduled payroll taxes throughout the 1980's. It also prospectively lowered the benefit replacement rate by 40% when fully effective in 1989 compared with prior law, correcting a largely unintended increase in the replacement rate enacted in 1972. The disability amendments of 1980 have likewise had a substantial effect on the growth rate of outlays in this part of the system. Since 1980 there have been four other major reforms that have significantly improved the fiscal condition of the social insurance programs:

- The 1981 Reconciliation Act amendments resulted in modest medicare and social security benefit cost savings, such as phasing out the adult student benefit, as well as initial steps to improve the solvency of the unemployment insurance program;
- The 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) amendments had a major cost restraining impact on medicare by limiting hospital reimbursements. The TEFRA amendments also extended medicare coverage and corresponding payroll taxes to Federal employees;
- The 1983 bipartisan social security amendments increased contributions from workers and employers, restrained benefits through a 6-month COLA delay and imposed taxes on a portion of the benefits of higher-income beneficiaries. The amendments extended the effects of the 1981 Act on the unemployment insurance program; they also used the hospital restraints in TEFRA as the basis for the medicare prospective reimbursement reform, replacing "pay-what-it-costs" hospital reimbursement of past years with set fees for patients with specific diagnoses; and finally
- The 1983 bipartisan bill on railroad retirement increased employer pension contributions and conformed benefit payments more closely to social security in order to restore the system's solvency.

The accompanying chart shows the budget savings from these four reforms. Current services outlays will be \$23 billion less in 1985 and \$26 billion less in 1986 than they would have been under the pre-1981 law. Cumulatively from 1982 to 1986, \$84 billion or 5.5% will have been saved from the pre-1981 baseline. This is a remarkable achievement for programs that have traditionally been considered uncontrollable and almost untouchable.

SOCIAL INSURANCE AND RETIREMENT: SAVINGS ACHIEVED



Additional Savings Proposed

Because the recently enacted reforms of social security and railroad retirement represented carefully balanced bipartisan compromises, it would be inappropriate to re-open these issues. Therefore, the present budget proposals concentrate instead on the Federal retirement programs and medicare.

The 1985 budget proposes modest further reforms consisting mainly of COLA delays for Federal civilian retirement and previously proposed medicare savings. These would save a total of \$25 billion over 1985-1989 or 1.4% of the current services baseline. The remaining growth in this category could be reduced even further with additional needed reforms in medicare and Federal retirement.

The main proposals in the 1985 budget for social insurance and retirement programs are listed below. The first three are proposed to redress the past overindexation of Federal retirement benefits and the underindexation of medicare copayments:

- *Limit COLAs in Federal retirement programs.*—The payment date for COLAs would be shifted from June, 1984 to January, 1985 and January thereafter to match the COLA delay that has already been enacted for social security. COLAs would be limited to the lower of the CPI increase or the General Schedule pay increase, and limited to 55% of the full COLA on the amount of an annuity that exceeds \$10,000 beginning in 1985.

- *Increase SMI premium.*—The SMI premium was originally set at 50% of program cost, but has deteriorated significantly over the years so that it pays only 25% today. Under the proposal SMI premiums would gradually be increased to 35% of program costs by 1990.
- *Increase SMI deductible.*—The SMI deductible would be updated annually based on changes in an index of medicare's costs.
- *Increase employee and agency contribution to civil service retirement.*—Federal employees and matching agency contributions would increase from 7% in 1984 to 8% in 1985 and 9% in 1986.
- *Limit physicians reimbursement.*—Medicare reimbursements to physicians would temporarily remain at 1984 reimbursement rates. Medicare reforms in the last 3 years have affected primarily hospitals and beneficiaries while physicians fees have been little affected.
- *Cover railroad workers under regular State/Federal unemployment insurance.*—This would assure availability of unemployment benefits for railroad workers whose separate unemployment insurance system is insolvent.
- *Correct the deteriorating financial condition of the Pension Benefit Guaranty Corporation (PBGC).*—This proposal would increase PBGC premium charges to assure that it can remain self-financing.

These proposals and others are discussed in more detail in the factsheets that follow. Together they would save \$1.6 billion in 1985, growing to \$24.8 billion by 1989.

Further Savings Proposed

(Outlays in billions)

Major program area	1985-89		
	Current services	1985 request	Proposed savings
Medicare.....	\$438.6	\$419.8	\$18.8
Social security	1,083.9	1,083.9	....
Federal retirement ¹	139.9	134.5	4.8
Unemployment insurance	83.3	83.3	....
Other	31.1	29.9	1.2
Total, social insurance and retirement.....	1,780.3	1,745.7	24.8

¹ Excludes the military retirement fund and Federal employee contributions to the civil service and military retirement funds.

The More Restrained Growth in the Future

As a result of the already enacted and proposed reforms summarized above, the outlook for the 1980's reflects significant progress in bringing social insurance and retirement cost growth within sustainable limits. Given the President's proposals, the average annual percent real growth is estimated to be reduced from a rate of 13.3% in the early 1970's to 3.3% from 1985 to 1989 under current services, or 2.7% assuming enactment of the President's proposals. Most revealing, however, is that these programs are no longer growing as a share of GNP and are projected to decline, as illustrated in the previous table.

A significant measure of success achieved thus far in both slowing the growth and restoring the solvency of the major social insurance programs is due to the acceptance of the dedicated financing principle. Thus, when outlays recently were substantially outrunning trust fund receipts, reforms adjusted both benefits and receipts to reestablish a balance. To be sure, the dedicated financing principle is not universally applied to all of the social insurance programs. Medicare, some unemployment compensation benefits, and Federal retirement annuities use general revenues. Neverthe-

less, dedicated financing has been the historical structure of these programs and the cornerstone on which the recent bipartisan reforms have been built. The principle of dedicated financing should continue to be a major factor in further reforms to the social insurance and retirement programs. Future reforms of the Federal employee retirement programs and medicare trust funds, which require general revenues to meet their obligations, will need to focus on this imbalance by increasing receipts and limiting the growth in benefits in order to further decrease the reliance of these programs on general fund financing.

In contrast to the substantial decline in growth rates for most social insurance and retirement programs during the 1980's, the decline in medicare has been considerably less dramatic. Real medicare annual growth rates have been reduced significantly since the 1970's when they averaged 10.2% annually, to an estimated 6.1% from 1985 to 1989 under present proposals. However, these estimated rates are still nearly four times greater than the growth of the rest of the programs in this category and more than 20 times the proposed annual rate of growth of the domestic budget from 1985 to 1989. The medicare trust fund is expected to be insolvent by the early 1990's unless further reforms are made. While the timing of the insolvency varies depending on who does the estimates, the insolvency itself is not in doubt under current law. Even if medicare weren't insolvent, the budget cannot sustain these real growth rates in excess of comparable rates for the domestic budget as a whole. Therefore, longterm structural reforms in medicare will eventually be required, as suggested by the first factsheet in this chapter.

The following factsheets cover the four major areas in social insurance and retirement: medicare, social security, Federal retirement and unemployment insurance. The fifth area, other social insurance, is described by three factsheets on railroad retirement, black lung and the Pension Benefit Guaranty Corporation.

Medicare

Medicare

Agency: Department of Health and
Human Services

[In millions of dollars]

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services: ¹							
Budget Authority.....	62,773	70,793	82,874	98,294	102,317	110,044	464,322
Outlays.....	59,653	69,105	76,936	86,606	97,214	108,709	438,571
(Premiums and collections).....	(-4,960)	(-5,908)	(-6,439)	(-6,870)	(-7,317)	(-7,768)	(-34,302)
1985 Budget Level: ¹							
Budget Authority.....	62,778	70,203	81,996	96,789	96,125	103,997	449,110
Outlays.....	59,503	68,073	74,871	83,177	92,092	101,587	419,802
(Premiums and collections).....	(-4,960)	(-6,015)	(-7,354)	(-8,928)	(-10,760)	(-12,878)	(-45,935)
Change:							
Budget Authority.....	+5	-590	-878	-1,505	-6,192	-6,047	-15,212
Outlays.....	-150	-1,032	-2,065	-3,429	-5,122	-7,122	-18,770
(Premiums and collections).....	....	(-107)	(-915)	(-2,058)	(-3,443)	(-5,110)	(-11,633)

¹ Budget authority and outlays include all HI and SMI offsetting receipts and collections, 99 percent of which are from SMI premiums. Only SMI premiums are affected by proposed legislation.

Program Description

Medicare is a Federally managed and subsidized health insurance program for persons 65 and older and those who are disabled or suffer from end stage renal disease (ESRD). Medicare covers approximately 28 million aged persons, 98% of all the elderly, and 3 million disabled persons. It consists of two parts:

- Hospital Insurance (HI or Part A), financed by Social Security payroll taxes, which helps pay for care delivered by hospitals, skilled nursing facilities, home health agencies, and hospices; and
- Supplementary Medical Insurance (SMI or Part B), the voluntary part of the program, which is financed by premiums paid by beneficiaries (currently 25% of program costs) and by general revenues. Part B helps pay for doctors, hospital outpatient and laboratory services, durable medical equipment, treatment for ESRD, and other medical services and supplies.

Current Status

The current projected rate of increase in medicare spending could, if left unchecked, jeopardize continued broad-based public support and acceptance of the medicare system. In constant dollars, the annual rate of growth in medicare expenditures since 1966 has been *more than double* that for total domestic spending.

Although originally designed to be a largely self-sustaining insurance program financed by a balance between payroll taxes and premium contributions, medicare increasingly has become a major draw on Federal tax dollars. In particular, the rate of increase in SMI premium financing has not kept pace with expenditure growth. By 1982, premiums financed only half as much in program expenditures as they had during the early years of the program.

The Administration and Congress have taken important bipartisan steps to address the explosive escalation of medicare expenditures. Under the Social Security Amendments of 1983, a new system was put in place which radically restructured the way medicare pays for hospital services. The new

prospective payment system (PPS) holds great promise for controlling increases in hospital expenditures by fundamentally altering provider incentives. Formerly, medicare rewarded inappropriate, or inappropriately long, hospital stays and other unnecessary uses of resources. The new PPS should have far-reaching effects, but more time is needed to determine its full impact.

The SMI program, on the other hand, continues to experience tremendous cost increases, but in the past has escaped close scrutiny and significant reform. The rate of increase in SMI benefits payments—80% of which are driven by payments to physicians—has averaged 20% annually since 1978, more than twice as fast as inflation in the general economy and about ten times faster than enrollment increases would suggest. At the same time, the proportion of the program subsidized by general revenues has grown substantially; the share borne by beneficiaries' premiums has eroded dramatically from 50%, when the program first began, to 25% currently. Consequently, the 1985 budget focuses on this priority area.

Constant Dollar Trends

Between 1967 and 1982 the constant dollar cost of medicare rose from \$7.6 billion to \$51.7 billion—a sevenfold increase. Real growth averaged 13.4% per year during this period. Between 1982 and 1984 the real growth rate fell to 10.0% per year. Under current services, the real growth rate is expected to fall further to 8.1% per year between 1984 and 1989, and to 6.7% per year if the policies recommended in the President's budget are adopted. Despite this welcome slowing in cost growth, 1989 constant dollar costs under current services are projected to exceed the 1984 level by 48% and the 1979 level by 149%.

Constant Dollar Trend

(1985 dollars in millions)

Year	Amount
1967	7,572
1970	15,295
1979	37,166
1982	51,670
1984	62,568
1989 current services.....	92,441
1989 budget.....	86,384

1985 Budget Proposals

The budget proposals, with almost \$19 billion in savings from 1985-89, represent a major step toward placing the medicare program on firmer financial footing. The major proposals would:

- Slow the increase in the current rate of expenditures by constraining the indexing of physician payments, on a one time basis. Temporarily freezing physician payments would save \$600 million while reducing the average medicare payment by about 4%. This follows the precedent of delaying cost of living increases established in the 1983 Social Security Amendments.
- Restore the economic value of the SMI deductible by tying it to the medicare economic index (MEI), making it more consistent with private industry levels. In 1985 the deductible would increase from \$75 to \$80, a level well below what would be required to make it comparable to deductibles established in private industry.
- On a phased basis, end medicare's mounting dependence on Federal tax revenues by restoring the balance in financing between SMI premiums and general revenues. Over six years, premiums would increase from 25% to 35% of program costs, a level significantly below that

experienced in the early years of the program, when premiums covered 50% of the program's cost.

The SMI premium would cover an additional 1.67% of program costs each year through 1990. In 1985, the premium would increase under this proposal a modest 40 cents per month or \$4.80 per year per beneficiary.

- Begin medicare eligibility coverage for individuals at the start of the first full month in which they are 65 years old. Under current law, eligibility can begin before an individual's 65th birthday occurs. This would make initial medicare eligibility consistent with initial eligibility in Social Security. Insurance gaps would not be created since most group plans extend coverage until medicare coverage begins.
- Contribute to systemwide health care reform by enhancing competitive behavior among medicare beneficiaries through a voluntary voucher program. Competition would also be encouraged by allowing competitive bidding for laboratory and other medical services.

The 1985 budget also includes \$171 million to be paid from the HI Trust Fund in 1985 for the new Peer Review Organization (PRO) program, which was created in 1982. PROs will play a critical role in ensuring that effective and appropriate care is being provided to beneficiaries under the new prospective payment system.

Finally, in addition to the proposals which directly affect the financial status of the medicare trust funds, the Administration is proposing to limit tax subsidies for employer contributions to their employees' health insurance premiums. Employer contributions above \$175 monthly for a family or \$70 for an individual would be treated as taxable income to employees. In addition to alleviating the distorted tax treatment accorded health insurance premiums, the proposal would moderate excessive increases in health care costs. This proposal would generate \$40 billion in tax revenues, which includes over \$2 billion in income to the medicare HI trust fund, over the next five years.

Currently, individuals have an incentive to purchase expensive health care policies with pre-tax dollars. These "first-dollar," low cost-sharing policies encourage excessive use of services with little cost-consciousness on the part of either providers or consumers. Further, the tax subsidy favors workers with higher incomes. This proposal would alleviate this inequity, allowing individuals and families to continue purchasing adequate health insurance policies. Approximately 22% of workers would have employer contributions above the cap, and would be subject to taxes in 1985.

Rationale

The medicare program represents a major and long standing commitment to the medical security of America's elderly and disabled citizens. Although there is general agreement about the nature and magnitude of the problem medicare faces, no clear consensus exists on a long range solution. The 1985 budget proposals recognize the major accomplishments that the Congress enacted in the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982 and the Social Security Amendments of 1983. Accordingly, the 1985 proposals focus on generally agreed upon reform priorities such as physician reimbursement, while allowing time to observe the effects of the significant reforms in hospital payments associated with prospective payment. In 1985, the proposals would temporarily limit SMI expenditures to achieve a more fiscally supportable growth rate of 14%, rather than the currently projected rate of 17% in 1985.

Social Security

Old Age, Survivors, and Disability Insurance

Agency: Department of Health and
Human Services

[In millions of dollars]

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority.....	175,900	197,619	212,365	226,354	267,145	298,942	1,202,425
Outlays.....	176,774	188,260	201,764	216,417	231,306	246,196	1,083,943
1985 Budget Level:							
Budget Authority.....	175,900	198,467	213,237	227,044	271,830	302,235	1,212,813
Outlays.....	176,774	188,259	201,764	216,417	231,306	246,196	1,083,942
Change:							
Budget Authority.....	....	+ 849	+ 872	+ 689	+ 4,685	+ 3,293	+ 10,387
Outlays.....	....	- 2	....	....	+ 1	....	- 1

Program Description

The Social Security program provides income to retired and disabled workers, their dependents, and survivors. The program is financed primarily by payroll taxes paid by employees, employers, and self-employed individuals.

Current Status

On April 20, 1983, the President signed into law the Social Security Amendments of 1983. This bipartisan legislation—recommended by the National Commission on Social Security Reform and endorsed by the President, the Speaker of the House, and the Majority Leader of the Senate—averted a financial crisis in the Old Age and Survivors Insurance (OASI) trust fund. Without this legislation, the OASI fund would have been unable to pay full benefits on a timely basis.

This legislation:

- extended Social Security coverage to Government workers and others not previously covered by Social Security;
- taxed a portion of social security payments going to higher income workers;
- shifted automatic benefit increases to a calendar year basis;
- rescheduled social security payroll tax rates;
- made self-employed tax rates equal to the combined employee-employer tax rates;
- provided a means to reimburse the trust funds for costs that should be borne by other appropriations;
- gradually increased the age of eligibility for benefits, beginning in the year 2000; and
- created safeguards that stabilize and restore the solvency of the OASI trust fund.

Constant Dollar Trend

During the last four years of the 1980's, social security constant dollar outlays will be four times greater than during the 1962-65 period. However, the unsustainable growth momentum of the late 1960's and 1970's has dramatically abated. Constant dollar costs in 1986-89 will represent only a \$183 billion or 29% real increase over 1978-81. By contrast, the latter represented a \$417 billion or 200% increase over 1962-65.

Constant Dollar Trend in Four-Year Intervals

(1985 dollars in billions)

Period	4-year constant dollar cost	Change over prior period
1962-1965	\$204.4	....
1966-1969	267.8	+31.0%
1970-1973	368.8	+37.7%
1974-1977	515.9	+39.9%
1978-1981	621.4	+20.5%
1982-1985	733.6	+18.0%
1986-1989	804.6	+9.7%

Constant Dollar Trend on an Annual Basis

(1985 dollars in millions)

Year	Amount
1962	46.8
1972	93.8
1982	175.6
1985 current services.....	188.3
1989 current services.....	209.4

1985 Budget Proposal

Consistent with last year's bipartisan agreement on social security reform, no changes in current law spending are proposed for social security.

The additional budget authority shown in the table above results from the proposal to include a portion of health insurance premiums paid by employers in employees' income. This change is discussed in greater detail in the section on Medicare.

Federal Retirement Programs

Federal Employee Retirement and Disability

Agency: Office of Personnel
Management

[In millions of dollars]

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority.....	37,220	39,702	42,585	45,567	48,376	51,092	227,322
Outlays.....	22,593	23,990	25,999	27,878	29,781	31,702	139,349
1985 Budget Level:							
Budget Authority.....	37,200	40,419	44,917	48,318	51,575	54,738	239,967
Outlays.....	22,342	23,573	25,167	26,865	28,592	30,315	134,512
Change:							
Budget Authority.....	-19	+717	+2,332	+2,750	+3,200	+3,647	+12,645
Outlays.....	-251	-416	-832	-1,013	-1,189	-1,387	-4,837

Program Description

Civilian retirement and disability programs pay benefits to former employees and their survivors who meet eligibility requirements based on age and length of service. Unreduced benefits are available as early as age 55 with 30 years of service. Benefits are based on the employee's three highest salary years and are indexed to the Consumer Price Index (CPI). Current workers and their employing agencies each contribute 7% of wages toward retirement costs which provides only 38% of the actuarial cost of benefits.

Members of the Coast Guard (CG) and of the Commissioned Corps of the Public Health Service (PHS) receive military retirement benefits and are covered by social security. Although for most civilian employees the civil service retirement system is separate from the social security system, new employees hired after December 31, 1983 are covered under a combination of social security and a temporary version of the civil service retirement system.

Under existing law, an estimated 2.0 million civilian, CG and PHS retirees and survivors will receive payments totaling an estimated \$24.0 billion in outlays in 1985.

Current Status

Recent surveys show that the benefits offered under the civil service retirement system are far superior to those offered by the average private-sector employer. Because of substantial growth in the number of beneficiaries and liberal benefit features, especially automatic cost-of-living adjustments and early retirement ages, program outlays grew rapidly over the last two decades. The program now has an unfunded liability, under present economic conditions, of \$515 billion.

Constant Dollar Trend

The constant dollar costs of Federal retirement programs (excluding military retirement) exploded between 1962-1981—rising more than *six-fold* during this 20 year period. The annual real growth rate averaged 9.8%. Due to reforms implemented by the Reagan Administration and the slowing of growth in new annuitants, the average annual constant dollar growth rate fell to 2.4% between 1981 and 1984. Under current services, annual real growth is projected to average 2.6% between 1984 and 1989.

Constant Dollar Trend

(1985 dollars in millions)

Year	Amount
1962	3,657
1971	8,309
1981	22,089
1984	23,697
1989 current services.....	26,958

1985 Budget Proposals¹

In 1985, the Administration will focus its legislative effort on three major civil service retirement reform proposals: cost-of-living adjustment (COLA) reform, a high 5-year salary average for the benefit formula, and increased employee and agency retirement contributions.

Automatic cost-of-living adjustments account for more than a third of the actuarial cost of the civil service retirement system. The Administration's COLA reform proposals would: 1) shift the payment date for the next COLA increase from June 1984 to January 1985; 2) establish January as the annual adjustment date and adjust the CPI measurement period accordingly; 3) repeal the 1982 Reconciliation Act provision for a minimum 3.3% COLA in 1985 for retirees under age 62; 4) change the COLA formula to the lower of CPI or General Schedule (GS) salary growth beginning in 1986; and, 5) apply full indexation only to those annuities not exceeding \$10,000—approximating the maximum primary social security benefit—with a 55% COLA adjustment for that portion of an annuity exceeding this amount. These reforms would bring COLAs for Federal civilian retirees into closer alignment with COLA practices in the non-Federal sector.

The Administration also proposes to revise the benefit computation base from the retiree's highest three years of earnings to the highest five in anticipation of continued low inflation. Employees now eligible for retirement or within three years of retirement eligibility would not be affected.

Although retirement costs have skyrocketed, the portion withheld from Federal employees' salaries has remained constant at 7% since 1969. The Administration proposes to increase the employee and agency retirement contribution from the current 7% to 8% in 1985 and 9% in 1986.

The budget also proposes smaller changes in Federal civilian retirement that are consistent with enacted reforms in social security. These include lowering the maximum eligibility age for adult students and deleting guaranteed minimum benefits. In addition, new D.C. Government employees hired after September 30, 1984 would not be eligible for coverage under civil service retirement.

Rationale

The overall objective of the Administration's 1984 and 1985 civilian retirement reforms is to achieve greater comparability of benefits with those typically found in the private sector. More significant reforms, such as those forwarded with the 1984 budget, would be necessary to fully meet this goal. The 1985 retirement proposals present an excellent first step toward implementation of the 1984 reforms because:

- Current COLA indexation benefits are not comparable to private sector practices and are extremely costly.
- Retirement payments made by agencies and employees cover less than half of the system's costs. A shift of more of the cost burden to employing agencies and employees has long been

¹ See factsheet on Military Retirement for a description of the reforms that would apply to Coast Guard and PHS Commissioned Corps retirees.

warranted. Such a shift would provide incentives for more appropriate program and personnel management decisions.

- In the 1960's and 1970's the private sector moved to shorter salary averaging periods for benefit computations to offset benefit erosion due to inflation. With lower rates of inflation anticipated and adequate COLAs for Federal annuities, it is sensible to move to a 5-year average, which is now typical in the private sector.

Military Retirement Fund

[In millions of dollars] Agency: Department of Defense—Civil

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority	27,105	29,509	32,038	34,614	37,052	160,317
Outlays	17,644	18,920	20,144	21,372	22,641	100,720
1985 Budget Level:							
Budget Authority	27,324	30,786	34,001	37,261	40,296	169,668
Outlays	17,346	18,440	19,628	20,830	22,085	98,329
Change:							
Budget Authority	+219	+1,278	+1,963	+2,647	+3,244	+9,351
Outlays	-298	-481	-515	-541	-556	-2,391

Program Description

The 1984 Defense Authorization Act provides for the establishment of accrual accounting for military retirement at the beginning of 1985. The Military Retirement Fund will be established to which accrual payments will be paid and from which military retirees and survivors will receive benefits. Under accrual accounting, the full cost of current military manpower is more accurately reflected in the national defense category of the budget. Benefits for those already retired are more appropriately reflected in the Income Security category.

Spending for military retirement before 1985 was from the Department of Defense-Military category, and is therefore not included in the table.

Retirement benefits are available after completion of 20 years of service. For personnel entering the armed forces before September 1980 retired pay is based on a servicemember's highest basic pay. For those entering after September 1980, retired pay will be based on the average of the highest three years basic pay. Under accrual accounting, the armed forces will pay 51% of basic pay to the Military Retirement Fund to provide retirement benefits for all active and reserve service performed after October 1, 1984. For service performed before that date, Treasury will make payments to the Fund. Service members do not contribute toward military retirement benefits.

Under existing law, an estimated 1.5 million military retirees and their survivors will receive payments totaling an estimated \$17.6 billion in 1985.

Current Status

Under current law military retirees will receive cost-of-living adjustments (COLA's) in May of 1984, June of 1985, and March of each subsequent year. Non-disability retirees under age 62 are entitled to 3.6% and 3.3% COLA's in 1984 and 1985, respectively.

1985 Budget Proposals

The 1985 budget proposes to delay the May 1984 COLA to January 1985 and to grant subsequent COLA's in January. This change would provide the outlay savings shown above. The increase in budget authority over the current services level would result from larger force sizes assumed for the budget compared to the current services base.

Rationale

The January implementation date and the proposed delay would be consistent with the COLA changes proposed for civil service retirees. Military and civil service retirees would continue to receive COLAs in the same month.

Unemployment Insurance

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Unemployment Compensation

[In millions of dollars]

Agency: Department of Labor

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority.....	26,291	21,714	22,268	24,271	24,618	24,681	117,551
Outlays.....	18,931	18,271	17,686	16,957	15,527	14,886	83,326
1985 Budget Level:							
Budget Authority.....	26,291	21,837	22,435	24,503	24,910	24,990	118,675
Outlays.....	18,931	18,271	17,686	16,957	15,527	14,886	83,326
Change:							
Budget Authority.....	....	+123	+167	+232	+292	+310	+1,124
Outlays.....	....	....	....	....	....	....	....

Program Description

Unemployment benefits are paid to individuals who are temporarily out of work and are searching for jobs. About 97% of wage and salaried employment in the United States is covered by unemployment compensation.

Regular benefits (usually up to 26 weeks) are payable in all States. Up to 13 weeks of extended benefits are payable in States with high rates of unemployment among individuals covered by unemployment insurance. A temporary program of Federal Supplemental Compensation pays additional weeks of benefits to those who use up all the weeks of unemployment benefits to which they are otherwise entitled. This temporary program will pay benefits through March 1985.

Current Status

The unemployment compensation program reflects reforms enacted in 1981 which target the additional weeks of unemployment benefits paid under the extended benefit program to claimants in States experiencing high levels of unemployment.

As a result of these changes, outlays for benefits from 1984-1986 are estimated at \$1.2 billion less in 1985 constant dollars than they would have been in the absence of the reforms. This comparison includes the effects of the temporary program of Federal Supplemental Compensation.

Constant Dollar Trend

Outlays for unemployment insurance are heavily impacted by business cycle conditions. Nevertheless, the constant dollar statistics through 1980 indicate a clear trend toward higher recession-induced peak outlays and increased residual costs at their low-point during the business expansion. As a result of the reforms enacted by the Reagan Administration and the general restraint on temporary extra benefits during the 1981-1982 recession, both recession peak and expansion low-point outlays in the 1980's will be less than during the 1970's.

Constant Dollar Trend

(1985 dollars in millions)

Year	Amount
Recession Peak:	
1962	11,714
1972	15,817
1976	33,349
1983	32,407
Expansion Low-Point:	
1968	6,244
1973	11,137
1979	13,875
1989 current services.....	12,658

1985 Budget Proposal

No changes in current law spending for unemployment compensation are proposed in the 1985 Budget. The budget proposes extending coverage under the regular State/Federal unemployment insurance system to railroad workers who are currently covered under their own separate system. Under the proposal, railroads would begin paying into State and Federal unemployment funds on January 1, 1985. Benefits to railroad workers under the State/Federal unemployment insurance system would begin July 1, 1986, after balances to finance them had been built up. Until July 1, 1986, all unemployment benefits to newly unemployed railroad workers would be paid by States but would continue to be financed through the separate system that presently exists. Under the State system, railroad workers generally would be eligible for higher maximum weekly benefit amounts and the extended benefits available to all other workers during times of high unemployment.

Rationale

Covering railroad workers under the State/Federal unemployment insurance system would assure them of continued unemployment benefits, under the same terms and conditions as all other employees regardless of the future course of railroad employment.

- According to the Congressional Research Service, the separate railroad unemployment insurance system is insolvent and has been so for 18 of the last 23 years.
- The system has had to borrow from the rail pension fund in order to finance its benefit payments; even under the most optimistic assumptions, its debt to the rail pension fund will reach almost \$1 billion by the end of 1985.
- Under existing contribution schedules the separate railroad unemployment insurance system cannot finance its benefit payments and will have to borrow to meet its debt service obligations.
- Under the 1985 budget proposal the railroad unemployment insurance funding crisis would be resolved and all debts to the rail pension fund would be repaid by about 1994.

Other Social Insurance

Railroad Retirement

[In millions of dollars]

Agency: Railroad Retirement Board

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services: ¹							
Budget Authority.....	6,275	5,328	5,451	4,849	4,773	4,874	25,274
Outlays.....	3,860	4,061	4,206	4,287	4,465	4,722	21,741
1985 Budget Level: ¹							
Budget Authority.....	6,275	5,326	5,451	4,848	4,772	4,874	25,271
Outlays.....	3,860	4,057	4,202	4,282	4,458	4,714	21,714
Change:							
Budget Authority.....	....	-1	....	....	....	....	-3
Outlays.....	....	-4	-4	-5	-6	-7	-27

¹ Includes the Federal Windfall Subsidy, Railroad Social Security Equivalent Benefits, and the Rail Industry Pension Fund.

Program Description

The Railroad Retirement Board (RRB) administers social security equivalent benefits and rail industry pension payments for former railroad employees and their dependents. The rail industry pension is the only private pension administered by the Federal Government. About 351,000 former railroad employees also receive a windfall payment.

- Social security benefits are funded from the social security trust funds.
- Rail industry pension payments are financed primarily by rail pension contributions, which were collectively bargained by rail labor and management and enacted by the Congress, and direct subsidies by the American taxpayer.
- Windfall payments are wholly subsidized by the American taxpayer. The American taxpayer subsidy represents nearly \$1,100 per active railroad employee in 1985.

Current Status

On August 12, 1983, the President signed into law the Railroad Retirement Solvency Act of 1983. This Act averted a major financial crisis facing the rail industry pension system, and enabled continued payment of full rail pensions. The solvency crisis was brought about by inadequate rail sector funding of their pension plan. The major provisions of the legislation:

- shifted automatic benefit increases to a calendar year basis;
- conformed early retirement and other benefit payments more closely to social security;
- increased rail sector pension contributions;
- taxed rail industry pension payments and windfall payments under the same rules that apply to all other private pensions;
- added safeguards to protect social security benefits; and
- provided temporary Federal subsidies to the rail industry pension.

1985 Budget Proposal

The 1985 budget proposes no change to the current law financing and payment of rail pensions.

Black Lung Program

[In millions of dollars]

Agency: DOL/HHS

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority.....	1,716	1,310	1,753	1,753	1,768	1,778	8,362
Outlays.....	1,708	1,737	1,757	1,757	1,772	1,783	8,806
1985 Budget Level:							
Budget Authority.....	1,706	1,289	1,731	1,733	1,745	1,754	8,252
Outlays.....	1,708	1,706	1,735	1,736	1,750	1,759	8,686
Change:							
Budget Authority.....	-10	-21	-22	-20	-23	-24	-110
Outlays.....	....	-30	-22	-21	-22	-24	-120

Program Description

Coal miners who are disabled from chronic dust disease of the lungs as a result of their work in the mines are eligible for black lung benefits. Recipients get a monthly cash subsidy equivalent to 50% of the salary paid a GS-2 Federal worker as well as a full subsidy for disease-related medical expenses. The Department of Health and Human Services (HHS) pays benefits from general revenues for claims filed from 1970 to 1973. The Department of Labor (DOL) processes claims filed after 1973 and reviews all claims previously denied by HHS for possible approval under revised eligibility criteria. Claims approved by the DOL are to be paid by the mine operator found responsible for the disability. Benefits for eligible miners and survivors where no mine operator can be assigned responsibility, or where mine employment terminated before 1970, are paid from the Black Lung Disability Trust Fund (BLDTF). This fund is financed by mine operators through an excise tax on mined coal.

Current Status

The current cost of the black lung programs includes savings resulting from enactment of reform legislation in 1981. That legislation required stricter evidence of disability due to black lung for claims filed on or after January 1, 1982. Previously, claimants could get assistance without showing medical evidence that they were disabled by black lung disease. In addition, the excise tax on mined coal was doubled, beginning January 1, 1982, to improve the solvency of the trust fund. This legislative change has increased expected coal tonnage tax revenues by \$2.2 billion over the period 1982-1989.

Constant Dollar Trend

The constant dollar costs of the black lung program increased rapidly during its initial phase—rising from \$26 million in 1970 to \$2.2 billion by 1973. After declining in real terms to \$1.6 billion by 1978, a renewed surge of constant dollar growth occurred in the late 1970's—culminating in a peak constant dollar outlay level of \$2.4 billion in 1980. Due to restraint on cost of living increases and caseload decreases, constant dollar costs fell by 25% by 1984. Under current services, constant dollar costs are projected to decline through the remainder of the 1980's—with 1989 current services outlays representing a 37% drop from the 1980 peak level.

Constant Dollar Trend

(1985 dollars in millions)

Year	Amount
1970	26
1973	2,167
1978	1,601
1980	2,397
1984	1,792
1989 current services.....	1,516

1985 Budget Proposal

In general, the budget request continues funding of Black Lung at the current services level. The proposal to limit Federal pay increases in 1985 to 3.5% effective January 1, 1985 will reduce outlays for black lung benefits by \$120 million over the 1985-1989 period.

Pension Benefit Guaranty Corporation

[In millions of dollars]

Agency: Department of Labor

Level	1984	1985	1986	1987	1988	1989	Total 1985-89
Current Services:							
Budget Authority ¹.....	....	1	2	3	4	5	13
Outlays.....	-17	....	13	25	41	58	138
1985 Budget Level:							
Budget Authority ¹.....	....	....	1	2	3	5	12
Outlays.....	-118	-154	-156	-175	-192	-208	-884
Change:							
Budget Authority ¹.....	....	....	....	....	....	....	-1
Outlays.....	-101	-154	-168	-200	-233	-266	-1,022

¹ PBGC will need no budget authority in the 1985-1989 period. However, the method for allocating the allowances for civilian agency pay raises among the categories used in this volume results in showing budget authority in this table.

Program Description

The Pension Benefit Guaranty Corporation (PBGC) insures the payment of pensions to workers participating in privately established defined benefit pension plans. These plans are established by employers, usually under collective bargaining agreements, and promise employees a specific monthly retirement income based upon the employees' earnings and years of service. Employers contribute annually to trusts set up to fund the promised pensions. As a result of various factors, including increases in promised benefits, the level of employer contributions, and changes in work and retirement patterns, many such trust funds do not have current resources to cover the costs of the promised pensions. If such a plan terminates, the PBGC assumes responsibility for the trust fund assets and the pension payments, making up any deficiency from its resources. The PBGC finances its responsibilities through an annual premium assessed on each plan (currently \$2.60 per participant in single employer plans), through collection of liabilities placed by law on the net worth of employers terminating plans, and through earnings on investments.

Current Status

Legislation enacted in 1980 changed the insurance program for pension plans established to serve workers employed by several firms (multi-employer plans) in order to reduce the claims on PBGC. Employers withdrawing from such plans must pay to the plans their fair share of unfunded pension promises; multi-employer plans facing severe solvency problems must reorganize and, if necessary, reduce promised benefits; and the PBGC will make repayable advances to insolvent plans to assure that benefits currently due are paid.

The single employer program, however, is in difficulty. Premiums and other income are not enough to cover the unfunded value of promised benefits in plans that have terminated. Moreover, some employers are attempting to terminate plans not because they have failed or are threatened with failure, but merely because they wish to avoid the future costs of financing the benefits they have promised their employees. Unwilling to bear the cost of their own actions, they hope to shift the unfunded portion of their pension plans on the PBGC, and ultimately on the responsible employers who are successfully maintaining their plans and will have to pay the PBGC insurance premiums in the future.

At the end of 1980 the PBGC had a total deficit—the excess of the current value of unfunded benefits over current assets—of \$159 million. By the end of 1983, the deficit had grown to \$415 million. If no changes are made, by the end of 1985 the deficit is expected to exceed \$620 million. By 1986, PBGC will be spending more than it takes in. It will continue to be unable to accumulate the

resources needed to pay benefits to participants from plans already terminated who will retire in the future. It will continue to be unable to obtain the resources needed to assure future benefits to participants of newly terminating plans. But in addition it will have to dip into the inadequate resources it now has in order to make current payments to workers who have already retired.

1985 Budget Proposal

The budget proposes legislation to increase the premium for single-employer plans to a level that will permit the current deficit to be amortized over a reasonable period of time. The Congress is asked to enact a \$7.00 per participant premium this year, and to apply the premium increase to all plan years beginning after December 31, 1983. In addition, legislation is proposed to prevent solvent employers from unjustifiably shifting the cost of their pension promises to the pension insurance system.

Rationale

The cost of private pension promises should be borne first by those who make them. A reasonable insurance program to spread the cost of unexpected and unavoidable plan terminations among all pension plans is sustainable only if the premiums required are not inflated by unwarranted plan terminations.

The reasonable increase of the annual single-employer plan, premiums from \$2.60 to \$7.00 per participant, effective this year, would permit the current deficit to be amortized in 15 years. This is the same period that the law allows private pension plans to amortize their experience losses.

The premium increase, when coupled with the additional investment income it would generate, would limit the cumulative deficit to about \$375 million at the end of 1985 and increase PBGC receipts from premiums and interest by \$1 billion over the 1985-1989 period.