UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

HUMAN RESOURCES
DIVISION

B-164031(4)

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MAY 6, 1983

The Honorable Les Aspin
House of Representatives

Dear Mr. Aspin:

Subject: Updated Estimates of the Savings If the Social Security Benefit Formula Which Favors Short-Term Workers Was Revised (GAO/HRD-83-54)

On March 30, 1982, you requested that we update previous estimates of the potential savings to the social security trust funds should the short-term worker advantage be removed from the formula for calculating social security benefits. The previous estimates were included in our report to the Congress entitled "Revising Social Security Benefit Formula Which Favors Short-Term Workers Could Save Billions" (HRD-81-53, Apr. 14, 1981). You also requested that we identify the groups and approximate numbers of individuals that realize this advantage and that would be affected by a change in the formula removing the advantage.

Updated estimates made for us by the Social Security Administration's (SSA's) actuaries in December 1982 show that revising the benefit formula using the methods discussed in our April 1981 report would save social security over $5 billion for individuals first retiring during the 7-year period from 1984 to 1990. The detailed actuarial estimates are included in the enclosure.

With regard to identifying those affected by our recommended formula change, personnel from SSA and the Office of Personnel Management told us that the information you desired about Federal employees and other affected groups is not available and that developing accurate data or estimates could not be accomplished to meet your time frames. Consequently, as agreed with your office on January 25, 1983, because such data could not be developed in time for consideration as part of the legislative deliberations on social security reform, our response is limited to an update of our previous report.

(105202)

It should be noted that the social security reform legislation, Public Law 98-21, signed by the President on April 20, 1983, reduces the windfall benefits for certain individuals first eligible for retirement benefits from both social security and noncovered employment after December 31, 1985. This legislation:

1. Applies a different benefit formula to retired and disabled workers who are eligible for a pension from noncovered employment. The new formula applicable to those with pensions from noncovered employment would compute the benefits by substituting 40 percent for the present law's 90-percent factor, but the reduction to 40 percent is phased in over a 5-year period.

2. Guarantees that the resulting reduction in the worker's social security benefit cannot be more than one-half the amount of the pension from noncovered employment.

3. Exempts certain employees, including those with 30 or more years of social security coverage, from the provision.

As noted in our previous report, the social security benefit formula favors not only people who have had low earnings over a lifetime of continual employment, but also those whose average earnings are low because of many years without covered employment. While the importance of providing greater replacement of preretirement earnings to those who worked at low wages for a lifetime is well recognized, one could question whether intermittent workers should get a similar advantage.

We identified two methods of removing the short-term worker advantage--the "continuation factor" and the "bend point" method. While we are briefly explaining these two methods below, a more detailed explanation can be found in our previous report.

The continuation factor removes the short-term worker advantage by allowing full benefits only to people who have worked a lifetime[1] in covered employment. It does this by adding a step to the benefit computation process, which applies a factor--based on the portion of a person's lifetime spent in covered employment--to the computed benefit amount. For example, persons who worked throughout their lifetime in covered employment would receive all of their computed benefit, while those who worked only half of their lifetime would receive 50 percent of their computed benefit.

The bend point method removes the short-term worker advantage by limiting the amount of earnings that may be applied against the highest rate (90 percent) of the benefit formula.[2] All remaining earnings must be applied to the lower rates (32 percent or 15 percent) of the benefit formula. The first bend point ($254 in 1983) is the AIME above which the benefit formula rate changes from 90 to 32 percent.

New estimates provided by SSA's actuaries in December 1982 show that potential trust fund savings from individuals who initially retire during the period 1984-90 would range from $5.2 billion using the continuation factor to $6 billion using the

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[1]A lifetime is considered as the computation period used in the social security benefit formula. The computation period for social security benefits is generally defined as the number of years between 1950 (or the year the worker turns 21, if later) and the year that the worker attains age 62, becomes disabled, or dies, excluding the 5 years of lowest covered earnings.

[2]A worker's social security benefit is determined by a multi-step process. First, the worker's covered earnings are updated (indexed) to reflect increases in the average wage of people working under covered employment. These updated earnings, expressed as a monthly rate, are called average indexed monthly earnings (AIME). The worker's AIME is applied to the benefit formula to determine the individual's primary insurance amount (PIA). The PIA is the monthly amount payable to a worker retiring at age 65 or upon disability. For workers initially qualifying for benefits in 1983, the formula for computing the PIA is:

90 percent of the first $254 of AIME, plus
32 percent of the next $1,274 of AIME, plus
15 percent of the AIME above $1,528.

bend point method. Our previous estimates of savings of $11 billion to $15 billion were higher than our new estimates for two reasons. First, they were projected over a 10-year period instead of a 7-year period, and second, unlike the new estimates, the previous ones did not reflect the offset to some of the savings due to increased spouse benefits that the program would have to pay under certain conditions. The latter situation exists because when persons are entitled to retirement benefits on their own account as well as to another higher benefit, such as spouse's benefits, the program will pay the retirement benefit plus the difference between this benefit and the higher one. Consequently, any reductions to the retirement benefit for such persons dually entitled could be counteracted by an accompanying increase in the amount of the other benefits to which the person is entitled.

Although full use of the continuation factor could save about $5.2 billion, it could be implemented on a limited basis and applied only to retirees who had spent less than a designated part (such as 25 or 50 percent) of their work life in covered employment.

In our previous report we stated that:

> "To reflect the traditional compromise between social adequacy and individual equity objectives the continuation factor's 'full coverage before full benefit' requirement could be modified and still achieve substantial savings."

The following schedule shows SSA's current estimate of the trust fund savings possible if the continuation factor were applied only to workers whose covered employment was less than a designated portion of their working lifetime.

Savings by Applying "Limited" Continuation Factor to Workers With Less Than a Designated Portion of Their Working Life in Covered Employment

Fiscal year	3/4 of elapsed period	2/3 of elapsed period	1/2 of elapsed period	1/3 of elapsed period
	(millions)			
1984	$ 31	$ 26	$ 12	$ 2
1985	148	122	56	12
1986	318	261	127	29
1987	507	421	215	50
1988	725	608	323	74
1989	981	830	440	102
1990	1,248	1,055	567	138
Total	$3,958	$3,323	$1,740	$407

Limited implementation of the continuation factor has a disadvantage in that it introduces some significant differences between the benefits of people who have just enough social security quarters of coverage to avoid application of the continuation factor and those who fall just a little short (a "notch" effect). Such a sharp distinction between these people may not be desirable. Also, some of the savings may not be achieved because of the relatively modest effort required for some people to attain the additional quarters of coverage necessary to avoid application of the factor.

In using the updated estimates of savings that could be realized from eliminating the short-term worker advantage, it is important to keep in mind that using either the continuation factor or bend point approach--depending on how "short-term worker" is defined--could affect the benefits of many retirees, although in many cases to a minimal extent. This happens because these approaches involve using benefit computation formulas that begin reducing the benefit for everyone with more than 5 nonwork years (except in the case of the "limited" continuation factor approach) after age 21 and before age 62. Workers with the shortest covered work histories incur the largest reductions in benefits.

Although we are unable to provide the data you requested on the extent to which certain groups of beneficiaries--such as government workers, spouses, and aliens--would be affected by the elimination of the short-term worker advantage, our recent report "Issues Concerning Social Security Benefits Paid to Aliens" (GAO/HRD-83-32, Mar. 24, 1983) contains some data on that group which may interest you. It shows that some aliens receive the short-term worker advantage by working in this country for less than their full working lifetime and then retire abroad. A copy of the report has been sent to your office.

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As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of the report until 14 days from its issue date. At that time, we will send copies to the Secretary of Health and Human Services; the Director, Office of Management and Budget; the Commissioner of Social Security; and other interested parties and make copies available to others upon request.

Sincerely yours,

Philip A. Bernstein
Director

Enclosure

Estimated reduction in OASDI benefit payments under several proposals for a length-of-service factor in the OASDI benefit formula

(In millions)

	Adjustment applies to all workers		Continuation factor applies to workers with covered employment less than:			
Fiscal year 1/	Bend point	Continuation factor	3/4 of elapsed period	2/3 of elapsed period	1/2 of elapsed period	1/3 of elapsed period
1984	$49	$42	$31	$26	$12	$2
1985	226	193	148	122	56	12
1986	482	414	318	261	127	29
1987	773	663	507	421	215	50
1988	1,124	969	725	608	323	74
1989	1,502	1,301	981	830	440	102
1990	1,892	1,648	1,248	1,055	567	138
Total, FY 1984-90	6,048	5,230	3,958	3,323	1,740	407
Proportion of beneficiaries coming on rolls in 1988 with lower benefits than under present law.........	28%	25%	14%	11%	8%	4%
Proportion of reduction in benefit payments attributable to benefits paid on the earnings records of:						
Male workers......	61%	62%	2/	2/	2/	2/
Female workers....	39	38	2/	2/	2/	2/

1/ Estimates are based on the assumption that the proposal is effective for workers first eligible in calendar year 1984 and later.

2/ Not estimated.

Note: The above estimates are based on the economic assumptions used in alternative II-B of the 1982 Trustees Report. See GAO study "Revising Social Security Benefit Formula Which Favors Short Term Workers Could Save Billions" dated April 14, 1981 for a description of the proposals.

Social Security Administration
Office of the Actuary
December 27, 1982

ENCLOSURE I