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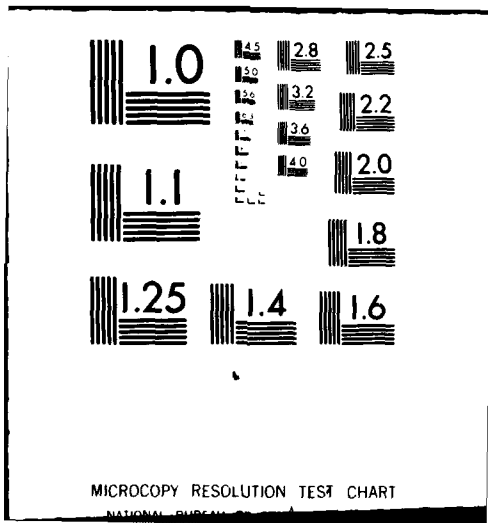
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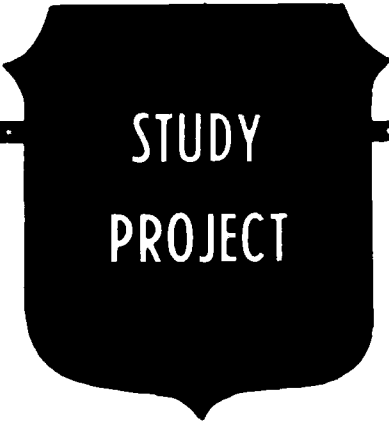
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SOCIAL SECURITY--AN INSTITUTION IN CRISIS

by

Lieutenant Colonel Richard P. Diehl, Infantry

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USAWC MILITARY STUDIES PROGRAM PAPER

SOCIAL SECURITY--AN INSTITUTION IN CRISIS

INDIVIDUAL STUDY PROJECT

by

Lieutenant Colonel Richard P. Diehl, Infantry

US Army War College
Carlisle Barracks, Pennsylvania 17013
16 May 1980

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PREFACE

This Individual Study Project was designed to produce a clear, plain language text for publication to explain to the "non-expert" the Social Security System and the challenges currently confronting it. It provides examples of how to compute pension benefits, provides a comparison with the French and German systems, and provides commentary concerning the future of the system.

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SOCIAL SECURITY--AN INSTITUTION IN CRISIS

Are you aware that, if the country experiences a recession with a resultant decline in economic growth in 1980, the social security pension fund would in essence be bankrupt by January 1984? The fund would not have sufficient monies to pay benefit checks due at the beginning of that month. That is the projection which was presented to Congress in 1979. That is particularly alarming given the Carter administration's anti-inflationary policies that promise to bring on just such a recession and decline in economic growth.

At least weekly, an article is published in your local newspaper or in your favorite news magazine or on a television news program that discusses the vast problems confronting the managers of the social security system. Various advisory panels study the system periodically and make recommendations to Congress and to key policy makers. Such an advisory panel recently (December 1979) completed its exhaustive study. A statutorily-constituted Board of Trustees reports to Congress annually concerning the state of the system to include its current and projected solvency. That Board presented the alarming projection mentioned above in its most recent report.¹ Were you to visit your local Social Security Administration office you could gather at least twelve pamphlets² that explain various parts of the system. Scholars have written scores of volumes about the system and its strengths, weaknesses, and inadequacies. There is probably not another socially-related system more closely scrutinized and intensively managed than is social security. Why then is the system in such a state of crisis? Why have 98 government bodies in 16 states stated they will withdraw from the Social Security program in 1980 while 147 others have stated their intention to withdraw in 1981?³ Why with the plethora

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of information available about the Social Security Administration and the system it manages does the average American feel perplexed about social security benefits for which he or she will be eligible one day? Why is he or she faced with increasing costs and the possibility of decreased benefits in the future?

Those are some of the questions that intrigued this author. Yet, the search for answers led to a series of baffling discoveries. Did you know at any point in time there are but three to five months worth of reserves in the social security pension fund? That means money you put in today is not put there for your retirement--it is there to pay the current retiree's pension. Did you know the buildings housing Social Security Administration offices have been built with your contributions? Did you know the "government employees" who man these offices are paid from your contributions? One need not look too far to confirm these facts. But, what about the "system"--what is social security; who is eligible; what can we expect for benefits on retirement? Those seemingly simple questions turn out to be extremely complex as one attempts to answer them as this author did. Even a visit to a local Social Security office could not unearth a simple explanation. As one reads the complex regulations in the Social Security Handbook, one becomes more and more confused. Even the local Social Security administrators acknowledge puzzlement over certain sections. Thus, needed is a plain language text that explains the basics of Social Security. Accordingly, this article will attempt to answer some of the questions Americans have about Social Security by: (1) describing the system in language as plain as possible, (2) using common examples to show amounts of Social Security Pension Benefits today's retiree can expect with a comparison to other Pension alternatives, (3) comparing briefly the German and French systems to the more recent vintaged American system, and (4) providing commentary about possible solutions for the future.

To begin, one must answer the question: are the contributions workers and employers pay federally-imposed taxes or insurance payments? Webster defines a tax as ". . . a charge, usually of money, imposed by authority upon persons or property for public purposes. . . ."4 Taxes are the means whereby a government pays for operations of the public apparatus and redistributes income. Insurance on the other hand is defined as ". . . coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril. . . ."5 This may seem to be a moot point as the program name--Federal Insurance Contributions Act--alone should define these contributions as insurance payments and not as taxes. Yet the Board of Trustees in its 1979 report speaks of this as an insurance program but at the same time states ". . . the taxes collected each year have been intended to approximately equal expenditures. . . ."6 Part of the reason Americans can not understand the system is Congress has over the years changed the program adding more and more welfare* features with an attendant set of complex rules for eligibility.7 This indicates members of that body look at these contributions at least tacitly as taxes which can be redistributed by statutory edict rather than as contributions supplied as a part of an "indemnity contract." In fact, retired workers and their widows (widowers) collect but 82% of the pension benefits paid out each year.8 The rest are to one degree or another welfare related. Other parts of the program are even more heavily welfare-weighted.

Social Security when it began in 1936 was not conceived as a welfare program. It was originally presented to Congress as a pension plan. Actually, it was an

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*Meaning legislated benefits given to some disadvantaged group rather than "paid for" returns to contributors.

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outgrowth of two factors: (1) the attractiveness claims by men such as Francis Everett Townsend⁹ and others that a "generous pension for life" was possible for all retirees who contributed during their working lives, and (2) as an effort by the Roosevelt Administration during the Depression to cope with the unemployment problems the country faced by removing retirement-aged employees from the job market, thereby freeing jobs for the younger unemployed.

The social security program is broken into four parts: (1)--pensions--known as Old-Age and Survivors Insurance, (2)--disability--known simply as Disability Insurance (this was added to the pension part of the program in 1957), (3)--hospitalization--known as Federal Hospital Insurance (this was added in 1965) and (4)--outpatient medical insurance--known as Federal Supplementary Medical Insurance. The first three parts are financed by equal employee and employer (or self-employed) contributions while the latter is financed by voluntary contributions of those eligible for Federal Hospital Insurance Benefits. Each of the four parts is managed as a separate trust fund. Funds can not be transferred from one trust to another without Congressional approval.

Table 1 shows briefly the amount of "cost growth" that has occurred in contribution levels. Note the comparison to 1970 levels--in ten years your "insurance premiums" have increased by 475% (self-employed 390%).

Table 1 Contribution Levels

<u>Year</u>	<u>Percent of Taxable Income</u>		<u>Maximum Wage Amount</u>	<u>Maximum Contributions</u>	
	<u>Employer/Employee</u>	<u>Self-Employed</u>		<u>Employer/Employee</u>	<u>Self-Employed</u>
1970	4.2%	6.9%	\$7800	\$328	\$ 538
1980	6.13%	8.1%	25,900	\$1588	\$2098
1981	6.65%	9.05%	29,700	\$1975	\$2688
1990	7.65%	10.75%	**		

Contributions are collected by the Internal Revenue Service and are allocated (in 1980) to each of the three contributory trust funds as shown in Table 2.

Table 2 Trust Fund Allocations

<u>Trust Fund</u>	<u>Percentage of Total</u>	<u>Percent of Taxable Income</u>	
		<u>Employer/ Employee</u>	<u>Self- Employed</u>
Old-Age and Survivors	70.63%	4.33%	6.01%
Disability Insurance	12.20%	.75%	1.04%
Federal Hospital Insurance	17.17%	1.05%	1.05%

About ninety percent of the work force is covered mandatorily by social security. The Social Security Act excludes railroad employees, federal (non-military) employees, employees of certain non-profit organizations, and state and local government employees who do not choose coverage. It is this latter group in which there is such a ground swell of withdrawals mentioned earlier. State and local government employee groups can--after they have been in the program five years--announce their intention to withdraw from it on two years' notice. The latest Advisory Council on social security has recommended Congress change the law to make government employee coverage mandatory to generate additional revenues and to close the loophole on which these employees can tap both the Federal Social Security coffers (after having contributed for the minimum period or through working a second job) as well as their local pension.¹⁰

Let us examine briefly each of the sub-programs, their trust fund accounts and those eligible for benefits under each sub-program. Recognize the system has complex eligibility rules; thus, statements to follow will be confined to the general rule rather than detailed exceptions.

OLD-AGE AND SURVIVORS INSURANCE TRUST

This is the original fund with which social security began in 1936. This is the retirement pension fund; yet as mentioned earlier, approximately 18%

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of benefits paid were to other than retirees or survivors of retirees.

Persons eligible for benefits are:¹¹

- (1) Retired "fully insured" workers over age 62.
- (2) Retired not "fully insured" workers over age 72.
- (3) Wife of a retired worker if she is over 62 or has the worker's less-than-18-year-old-child in her care.
- (4) The divorced wife of a retired worker if she is age 62 or older and had been married to the worker for 10 years.
- (5) The worker's unmarried child when under the age of 18 (22 if attending school full time).
- (6) A surviving spouse if she (or he) is 60 years old or older or caring for the worker's child who is either under 18 years of age or disabled or if she (or he) is age 50-59 and disabled.
- (7) The worker's dependent parents if they are 62 or older.

In addition, this fund pays a "lump sum death payment" to a maximum of \$255 to defray burial expenses.

One can readily see there is a mixture of true pension items, insurance protection items, and outright welfare. The Social Security Administration has a complex set of formulas to determine the extent of coverage based upon the total wages of the worker. The examples to follow will show how retirement benefits are computed.

Basically, though workers retiring today may have paid into social security since 1936, benefits are computed only on the worker's wage stream from 1951 until the time he or she retires (there is an exception for those with little or no wages after 1951 but with a wage history from 1937 to 1950). When social security administrators compute retirement benefits, they consider the actual

wages earned throughout the periods and modify past earnings by a process known as indexing earnings.

In simple terms this indexing is designed to reduce the difference between a person's early income and most recent income--the effect is to increase earlier wage levels artificially. The index uses as a base the average wage for all individuals paying into the social security system attained in the year the retiree attains age 60. This dollar amount is divided by a similar "average wage" in each of the past years of the worker's wage history. All the indexed wages are added together and are divided by the number of months in the wage earnings period to determine an average indexed monthly wage. Only part of the worker's earnings stream is considered. The total number of years considered are those between 1951 (or the year the worker became 21) and the year he or she becomes 62 years of age. The lowest five years of income are dropped from the computations. Currently, a monthly retirement benefit is computed using the following formula.

Retirement Monthly Benefit = 90% of the first \$190 of the average indexed monthly wage + 32% of the amount over \$190 up to \$1171 + 15% of the amount over \$1171.

That may seem complicated now but the examples to follow later should clear up any questions.

Benefits paid to the wives (or husbands)--if they are over 62 years of age--of retired insured workers generally are equal to one-half of the monthly benefit the worker receives. For those workers who retire prior to age 65 their monthly retirement benefit will be reduced by a small amount*** for each month they

***Reduction formulas: Worker 5/9 of 1% (1/180) per month; spouse 25/36 of 1% (1/144); widow(er) 19/40 of 1% (19/4000) per month between 60 and 65 plus 43/240 of 1% for each month prior to age 60.

received benefits prior to age 65. The spouse's and widow(er)'s benefits are similarly reduced for each month benefits were received prior to age 65.¹²

To be eligible fully for pension benefits--known as "fully insured for life"--the worker must have amassed forty "quarters of coverage" during his working life. Prior to 1978, a non-farm worker was credited with a quarter of coverage for each quarter of the calendar year (January-March, April-June, July-September and October-December) in which he was paid total wages of \$50 or more. Because of the seasonal nature of income of farm workers, quarters of coverage were based upon the calendar year; for each \$100 of total income during the year the worker was credited with one-quarter of coverage. Self-employed, generally, were credited with a quarter of coverage for each calendar quarter in which total income exceeded \$100. Beginning in 1978, all workers' quarters of coverage were computed similarly--by the total amount earned during the year. For each \$250 of wages, the worker was credited with one quarter; thus, if a worker had total wages of \$1000 or more he or she attained four quarters of coverage.¹³ In 1979, the minimum wage necessary for one-quarter of coverage was raised to \$260.¹⁴

In fiscal year 1978, workers and employers supplied a net contribution to the Old-Age and Survivors Insurance Trust Fund of just over \$74 billion. That fund began the year with reserves totaling over \$35 billion. However, disbursements during the year amounted to over \$81 billion. That equates to an average monthly disbursement of \$6 3/4 billion. Because

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disbursements exceeded contributions the reserve in the trust fund had to be reduced by nearly \$4 1/2 billion to just under \$31 billion. That reserve amounted then to but 4 1/2 months of average disbursements. It is this trend in disbursements exceeding contributions that would cause, given a recession in 1980, the fund not to have sufficient assets to pay amounts due in January 1984.

Monies held in the reserve do generate revenues. These reserves are invested by the Managing Trustees in interest-bearing obligations of, or guaranteed by, the Federal government. The investments under law must bear interest at a rate equal to the average market yield of four-year or longer interest-bearing government notes issued to finance the public debt. The portfolio of this trust fund now contains a variety of long-term Treasury bonds, certificates of indebtedness, and notes, as well as participation certificates of the Government National Mortgage Association, currently yielding from 2 3/4% to 8 1/2%; maturity dates vary between 1980 and 2007. The interest earned in the twelve months ending June 30, 1978 was 7.2%.

The fund incurs a considerable drain from administrative expenses, costs of vocational rehabilitation services, and transfers to railroad retirement accounts. Net administrative expenses for fiscal year 1978 were \$4.085 billion--that represents 50.4% of the interest gained on investments. Over \$13 million of the expenses were for construction of facilities for the Social Security Administration. Thus, the vast complex of buildings that house the "system" was actually built and paid for with fund contributions. Yet the balance sheets that represent the assets of this and the other trust funds are understated because these capital assets are not reflected therein. The rationale is these assets do not

represent funds available for benefit or administrative expenditures-- this varies from standard accounting practices in the private sector.

Costs of vocational rehabilitation services amounted to almost \$6.5 million in fiscal year 1978. Funds are provided annually to the railroad retirement accounts (\$1.588 billion in fiscal year 1978) under the provisions of the Railroad Retirement Act. These transfers are designed "to place each trust fund in the same position as it would have been if railroad employment had always been covered under social security."¹⁵ Thus, there is a considerable movement of monies to the non-contributing railroad worker accounts. Obviously Congress sanctioned this "Distribution of Income" program when it passed the Railroad Retirement Act.

DISABILITY INSURANCE TRUST

The disability trust fund provides benefits to qualified disabled workers, regardless of age, wives (or husbands) and children of disabled workers, disabled children of insured workers, and to widows and widowers over the age of 60.

The disabled worker can receive disability benefits regardless of age if he or she:

1. meets the definition of disability****
2. has 20 or more quarters of coverage in the 40 quarters that preceded the disability.

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****Disability--the inability to engage in any substantial gainful activity--ie performance of significant physical or mental duties or a combination of both which are productive in nature--which can be expected to result in death or has lasted or can be expected to last for a continuous period of not less than 12 months--blindness of 20/200 corrected or worse of a field of view of 20 degrees or less is considered a disability.

3. If disabled before age 31 have quarters of coverage equal to one-half of the quarters of coverage possible to be obtained after his or her twenty-first birthday; a minimum of six quarters of coverage is required. ¹⁶

The eligibility criteria for a spouse--to include divorced spouse--and non-disabled children of a disabled worker are the same as those if the worker were retired. A disabled widow or widower under the age of 60 may receive ¹⁷ disability benefits if:

1. He or she meets the definition of disability.
2. Becomes disabled within
 - a. Seven years of the worker's death
 - b. Seven years after the last month he or she was previously entitled to disability benefits.
3. Has been disabled throughout a waiting period of five consecutive months (unless he or she had previously been entitled to disability benefits).
4. Meets the regular surviving wife or surviving divorced wife criteria (essentially was married to the worker and has the legal status as a widow(er) in terms of the probating of personal property).

¹⁸
A disabled child may receive benefits if:

1. He or she meets the disability criteria.
2. Is the legal child of the worker.
3. He or she has been disabled since before age 22.
4. After the disability ends, he or she becomes disabled again within 84 months of when the last disability ended.

Disability payments end for any month in which the disabled person performs substantial gainful activity. Also, as a part of this program, the person receiving disability benefits may be required to undergo vocational rehabilitation training.

Should he or she refuse, without good cause, to undergo the training disability benefits are terminated.

Generally the benefit a disabled worker will receive is the same as that which he would receive under the retirement formula described earlier. If he is also receiving workman's compensation payments, the disability benefits may be reduced if the total payments exceed 80% of his average monthly income computed either using the indexing method, or his highest five consecutive years, or the highest calendar year in the six years preceding his disability.

The financial status of the Disability Insurance Trust Fund was in danger until Congress, in January 1978, raised the contribution rate from .575% to .775% (of taxable income). In fiscal year 1977 disbursements exceeded receipts by more than \$2.2 billion. As a result of the rate increase reserves increased in fiscal year 1978 by over \$100 million to \$4.371 billion. However, average monthly disbursements during fiscal year 1978 were just over \$1 billion--thus, the reserve at the end of that year represented less than 4 1/2 months of expected benefit and expense payments.

The investment policy of this trust fund is essentially identical to that of the other trust funds. Obligations held by the fund returned from 3 1/2% to 8 1/4%. The return on these investments for the twelve months ending June 30, 1978 was 7.4%. This amounted to over \$251 million. However, expenses far exceeded this non-contributory revenue. Net administrative expenses for fiscal year 1978 were \$327.2 million--that included \$1.6 million for construction of facilities. The cost of the vocational rehabilitation program in that same year was just under \$85 million.

FEDERAL HOSPITAL AND SUPPLEMENTARY MEDICAL INSURANCE TRUST FUNDS

These are two "add on" programs that have no connection to pensions. Commonly known as Medicare, they have been criticized the most of the four programs as being welfare-based. Indeed the 1979 Advisory Council on Social Security recommended that these two programs be detached from social security and be financed from specifically designated parts of personal and corporation income taxes.¹⁹ That council further recommended these programs be combined with Medicaid--a state-run program for the needy--into a comprehensive national health plan. Under current law there already is a certain detachment. Congress designated a separate agency--the Health Care Financing Administration--to administer these programs. That agency works through state agencies in fulfilling its management responsibility.

Any person, age 65 or older, who is entitled to benefits under social security is also entitled to the hospital insurance. The supplementary medical insurance is a voluntary program open to all persons 65 or older--the monthly rate charged for this insurance is \$8.70. The hospital part is financed from worker contributions at a rate of 1.05% of taxable income (out of the 6.13% and 8.1% employed and self-employed contributions, respectively). Generally, the worker who reached 65 after 1974 must be "fully insured" in terms of quarters of coverage, to be eligible for hospital benefits. Those who turned 65 prior to 1968 are eligible even if they have no quarters of coverage. The quarters of coverage requirement for those reaching 65 between 1968 and 1974 ranges from 3 to 21.

In addition to the aged population (23.5 million or 95% of those over 65 are covered by the hospital insurance), those eligible for disability insurance benefits are also eligible for hospital and supplementary medical insurance (2.8 million disabled are covered). Railroad retirement beneficiaries over

age 65 and those who are receiving railroad disability benefits are eligible. Those over 65 who are uninsured in social security or railroad retirement can voluntarily enroll in the hospital program by paying a monthly premium.

Almost everyone who has permanent kidney failure and who needs renal dialysis treatment is eligible for hospital and supplementary medical insurance. Specifically, if a person is fully or currently insured he (or she), his (or her) spouse and dependent children are eligible for kidney-related hospital and medical benefits.

These programs do not pay the entire amount. The beneficiary must pay for private insurance to supplement these federal insurance programs or pay the differences from his income or savings. Table 3 outlines the amount of coverage under this program.

Table 3 Hospital Insurance Coverage

<u>Time in the Hospital</u>	<u>Amount of Coverage</u>
Up to 60 days	All except \$160
61-90 days	All but \$40 per day
91-150 days	All but \$80 per day
Over 150 days	nothing

Coverage normally includes a semi-private room, board, and hospital expenses.

This program also has a feature known as "lifetime reserve days." Each person in the hospital insurance program has available 60 days in "reserve" to be drawn on if he or she has an extended hospital stay. If these days are used, the individual must pay \$80 of the total daily bill. Once used, the "lifetime reserve" is not renewable. In addition to hospital stays, this insurance will cover the costs of a skilled nursing facility given it is Medicare-approved.

Supplementary medical insurance (Medicare Part B) provides benefits for in-and-out patient medical services, physician expenses, blood, ambulance and certain other expenses. The individual pays the first \$60 of costs during a calendar year. After that level of costs is reached the insurance will pay 80% of "reasonable costs"--determined by Medicare administrators based upon reviews of average costs of doctors and suppliers in the area--for medical expenses or for out-patient hospital treatment. The insurance pays 100% of home health care expenses. The individual must pay for the first three pints of blood used--Medicare pays 80% of the cost of blood needed above that level.

One can readily see that these Federal insurance programs require private supplementary insurance to guard against catastrophic illnesses. Without such private insurance--which, incidentally, will normally pay only a portion (most pay 20% of the Medicare-determined reasonable charges of the individual's portion of the expenses) the individual could be severely strained financially.

Financially, these trust funds are in slightly better condition than are the other two. At the end of fiscal year 1978, the hospital fund had reserves of \$11.8 billion while medical insurance reserves were almost \$4 billion. That represents 7.8 months of disbursements for the hospital fund and 6.5 months for the medical insurance fund.

Interest on investments added \$780 million to the hospital fund in fiscal year 1978--that figure was \$229 million for the medical insurance fund. However, as with the other funds, administrative expenses were high--in fiscal year 1978 they were \$446 million for the hospital fund and \$500 million for the medical insurance fund. Total expenses charged to construction were \$132 million.

There are other programs administered by the Social Security Administration (SSA). The Supplementary Security Income Program--financed from general fund revenues--is a cash assistance program for the needy aged, blind or disabled. It provides a "floor" amount of income for the needy. In addition, applications for "Black Lung" benefits for coal miners affected with pneumoconiosis, and their families, are processed by the SSA.

Let us now look at that part that involves every worker--the pension part--and use simple examples to show what pension benefits social security will provide and what alternative systems offer.

Consider the income of three workers: Each attains the age of 63 on 31 December 1980. One worker earned the Congressionally-designated minimum wage all of his working life. The second earned an "average non-farm worker" wage and the third earned a wage sufficient to pay the maximum amount in social security contributions. For these examples we will assume all have worked constantly from 1950 through 1980 with the following income streams:

Table 4

Year	Minimum Wage	Soc	Average	Soc	Maximum Wage	Soc
	Worker	Secty Contr	Non-Farm Worker	Secty Contr	Worker	Secty Contr
1950	\$1500		\$2778	\$83.34	\$3600	\$108
1951	1500(5240.56)*	\$45	2778(9705.51)*	\$83.34	3600(12,577.34)*	\$108
1952	1500(4933.60)**	\$45	2778(9137.02)*	\$83.34	3600(11,840.63)*	\$108
1953	1500(4672.54)*	\$45	2778(8653.54)*	\$83.34	3600(11,214.10)*	\$108
1954	1500(4648.55)	\$60	2778(8609.12)*	\$111.12	3600(11,156.53)	\$144
1955	1500(4443.76)*	\$60	2778(8228.92)	\$111.12	4200(12,446.13)*	\$168
1956	1500(4152.79)*	\$80	3846(10,647.76)*	\$153.84	4200(11,627.82)*	\$168
1957	1500(4028.09)*	\$90	3846(10,328.01)*	\$173.07	4200(11,278.64)*	\$189
1958	1500(3992.91)*	\$90	3846(10,237.83)*	\$173.07	4200(11,180.15)	\$189
1959	1500(3804.44)*	\$100	3846(9754.58)*	\$192.30	4800(12,174.20)*	\$240
1960	1500(3660.77)*	\$120	3846(9386.22)*	\$230.76	4800(11,714.48)*	\$288
1961	1500(3589.77)*	\$120	4600(11,007.60)*	\$276.00	4800(11,486.19)*	\$288
1962	1500(3418.27)	\$125	4600(10,482.69)*	\$287.50	4800(10,938.46)	\$300
1963	1500(3336.45)	\$145	4902(10,903.51)*	\$348.00	4800(10,676.63)	\$348
1964	1500(3205.45)	\$145	4902(10,475.41)*	\$348.00	4800(10,257.44)	\$348
1965	1500(3148.75)	\$145	4902(10,290.13)*	\$348.00	4800(10,076.01)	\$348
1966	1500(2970.45)	\$154	4902(9707.44)*	\$377.45	6600(13,069.99)*	\$508.20
1967	1500(2813.72)	\$156	3704(6948.01)	\$288.91	6600(12,380.37)*	\$514.80
1968	2300(4036.91)*	\$174.80	4259(7475.31)	\$323.68	7800(13,690.40)*	\$592.80
1969	2600(4314.15)*	\$218.40	4815(7989.47)	\$404.46	7800(12,942.44)*	\$655.20
1970	2900(4584.43)*	\$243.60	5370(8489.10)	\$451.08	7800(12,330.53)*	\$655.20
1971	3200(4816.66)*	\$294.40	5926(8919.85)*	\$545.19	7800(11,740.60)*	\$717.60
1972	3200(4386.75)*	\$294.40	5926(7260.07)	\$545.19	9000(11,026.10)	\$828
1973	3200(4128.44)*	\$310.40	5926(7645.35)	\$574.82	10,800(13,933.47)*	\$1,047.60
1974	3800(4627.44)*	\$376.20	8261(10,059.81)*	\$817.84	13,200(16,074.27)*	\$1,306.80
1975	4000(4532.28)*	\$396	8888(10,070.73)*	\$879.91	14,100(15,976.29)*	\$1,395.90
1976	4400(4663.70)*	\$435.60	9565(10,138.25)*	\$946.94	15,300(16,216.96)*	\$1,514.70
1977	4600*	\$455.40	10,000*	\$990	16,500*	\$1,633.50
1978	5300*	\$535.30	11,778*	\$1189.58	17,700*	\$1,787.70
1979	5800*	\$589.28	13,609*	\$1382.67	22,900*	\$2,326.64
1980	6200*	\$629.92	1378*	\$1369.36	25,900*	\$2,631.44
Totals	\$105,568.27*	6723.70	237,380.01*	4173.22	327,709.85*	\$21586.08

*Denotes the 23 highest indexed earning years **Contributions are computed based upon the percent of taxable income in the applicable year. () Denotes "indexed" wages

In the examples above, the numbers in parentheses represent computed average indexed yearly earnings. The Social Security Administration uses the following average annual wage rates for computing these indexed values.

Table 5

Average Annual Wage Amounts (1951 - 1980) for a Number Holder Who Attains Age 62 in 1979

1951	\$2799.16	1960	\$4007.12	1970	\$6186.24	1980	\$11483.42
1952	\$2973.32	1961	\$4086.76	1971	\$6497.08		
1953	\$3139.44	1962	\$4291.40	1972	\$7133.80		
1954	\$3155.64	1963	\$4396.64	1973	\$7580.16		
1955	\$3301.44	1964	\$4576.32	1974	\$8030.76		
1956	\$3532.36	1965	\$4658.72	1975	\$8630.92		
1957	\$3641.72	1966	\$4938.36	1976	\$9226.48		
1958	\$3673.80	1967	\$5213.44	1977	\$9779.44		
1959	\$3855.80	1968	\$5571.76	1978	\$10556.03		
		1969	\$5893.76	1979	\$10884.76		

The workers being considered in these examples reached age 60 in 1977. The earnings of the average social security contributor for that year (\$9,779.44) became the base for computing indexed yearly wages. Examples of such calculations of indexed earnings are shown below:

Table 6

Indexed Wage Calculations

<u>Year</u>	<u>Minimum Wage Worker Indexed Wage</u>	<u>Average Non-Farm Worker Indexed Wage</u>	<u>Maximum Wage Worker Indexed Wage</u>
1965	$\frac{\$9779.44}{\$6186.24} \times \$1500 = \3148.75	$\frac{\$9779.44}{\$6186.24} \times \$4902 = \10290.13	$\frac{\$9779.44}{\$6186.24} \times \$4800 = \10076.01
1970	$\frac{\$9779.44}{\$6186.24} \times \$2900 = \4584.43	$\frac{\$9779.44}{6186.24} \times \$5380 = \$8489.10$	$\frac{\$9779.44}{6186.24} \times \$7800 = \$12330.53$

The number of wage years to be considered is the difference between the year the worker turns 62 years of age and 1951 (or the year he or she becomes 21 years of age if that is after 1951). In the examples, that difference between 1979 and 1951 is 28 years. Since the five lowest wage years are discarded, only the 23 highest wage years are considered. Those years are denoted by asterisks in Table 1.

To obtain the average indexed monthly wage (AIME)--which is used in computing the monthly retirement benefit--the total wages for the 23 highest wage years are divided by the number of months in those years (23 x 12 = 276). Thus, the AIME for those examples are:

Minimum Wage	$\$105,568.27 \div 276 = \382.49
Average Non-Farm Wage	$\$237,380.01 \div 276 = \860.07
Maximum Wage	$\$327,709.85 \div 276 = \$1,187.35$

The monthly retirement benefit is computed using the AIME thusly:

Minimum Wage Worker = $.9(194) + .32 (\$382.49 - 194) = \234.92
Monthly Benefit

Average Non-Farm Worker = $.9(\$194) + .32 (\$860.07 - 194) = \$387.74$
Monthly Benefit

Maximum Wage Worker = $.9(\$194) + .32 (1171-194) + .15(\$1187.35-1171) = \$489.69$
Monthly Benefit

However, in these examples the retiree will be receiving benefits for 24 months before he reaches the age of 65. His benefits will be reduced accordingly:

Minimum Wage Worker = $\$234.92 - \left(\frac{24}{180} \times 234.92\right) = \203.60
Monthly Benefit

Average Non-Farm Worker = $\$387.74 - \left(\frac{24}{180} \times 387.74\right) = \336.04
Monthly Benefit

Maximum Wage Earner = $\$489.69 - \left(\frac{24}{180} \times 489.69\right) = \424.40
Monthly Benefit

The retiree's spouse (if over 62) and dependent children will receive one-half of the amount of the monthly benefit. The total benefits a family may receive are fixed by a "maximum family allowance" which varies with the average monthly wage. However, one can readily see even the worker with the highest wage history experiences a substantial drop in income upon retirement. Unless he or she has a separate source of income, his or her standard of living must decline. Most workers spend their lives accumulating non-liquid capital assets, such as a house, rather than secondary income assets. That puts retired personnel and, particularly, surviving spouses in a liquidity dilemma.

Should the retiree die the spouse will receive survivor's benefits equal to 71% of retiree's benefit if she (or he) were age 60 to 62, 82% if she (or he) were age 62 to 65 and 100% if she (or he) were over age 65 at the time of application. For those spouses under age 60, they must have the retiree's dependent child in their care to receive benefits. The disabled spouse between the ages of 50 and 60 can obtain benefits which are less than 71% of the retiree's monthly benefit.

There is a minimum monthly retirement benefit set at \$122.00.

ALTERNATIVE PLANS

As mentioned earlier, Federal employees have a separate retirement and insurance plan. The Federal employee contributes 7.0% of his Federal income-- that is matched by the government. The retirees in the above examples would fair considerably better under the Federal plan than under Social Security. Under that plan the retiree's highest three consecutive years of wages are averaged. In these examples a Federal worker earning as shown in Table 1 would receive:

Minimum Example: \$3,358.69 yearly or \$279.89/monthly
Average Example: \$7,546.29 yearly or \$628.86/monthly
Maximum Example: \$12,912.08 yearly or \$1,076.01/monthly

It should be noted the minimum wage example is deceptive for no retiring Federal employees have their highest three wage years at the minimum wage. However, these examples are 37%, 87% and 153% higher, respectively, than Social Security benefits. With wives' benefits added, those figures are but -8.4%, 24.7%, and 69% above the Social Security levels. In addition, if this worker acquired 40 quarters of coverage under social security during his working life--either from a second job or job held outside of Federal employment-- he (or she) would be eligible for at least the minimum benefit under social security. Should the worker die, his or her spouse would receive 55.55% of the retiree's pension regardless of his or her age.

There are a variety of privately managed pension plans. Benefit amounts under these plans vary dependent upon the amount of contributions. There are normally managed by large financial institutions or insurance companies. The advantage the private company has is it can obtain a larger return on investment. Also, the private company is paid a management fee for its services; thus, the administrative expenses are lower and construction of capital assets is divorced from contributors' generated reserves.

*

One such large firm analyzed the Social Security payment streams of the above examples. For those payment histories the workers would receive the following monthly benefits on retirement:

- Minimum Wage =\$120.25
- Average Non-Farm Wage = \$225.03
- Maximum Wage = \$389.14

(Note the amounts are lower than Social Security. Even with a higher return on investment the private firm actuarially could not return a pension for life at the Social Security levels. This may be indicative of the central problem in the Social Security financing dilemma.)

Let us consider the option a worker may have of placing the amount of his (and his employer's) Social Security contribution in a bank at passbook interest rates. Using the examples above and the prevailing passbook interest rates of 2% in 1951 to 5 3/4% in 1980 (projecting increasing passbook rates linearly in the future years) the workers could obtain the following monthly withdrawals from their savings for the corresponding number of months.

Table 7
Number of Months Each Savings Account
Would Support Various Withdrawals

	<u>Withdrawal Amount</u>									
	<u>\$300</u>	<u>\$400</u>	<u>\$500</u>	<u>\$600</u>	<u>\$700</u>	<u>\$800</u>	<u>\$900</u>	<u>\$1000</u>	<u>\$1100</u>	<u>\$1200</u>
Minimum Wage	25	19	15	13	11	10	9	8	8	7
Average Non-Farm Wage	55	40	32	21	23	20	18	16	15	14
Maximum Wage	91	64	50	41	35	30	27	24	22	20

*Prudential--The benefit computations differed somewhat from others in our examples for they were based on an average of the yearly contributions rather than income stream of the examples; also these benefits were computed for a worker age 65 who retires on January 1, 1981.

FRENCH AND GERMAN COMPARISONS

The French and German social security systems have the same goal as the American system--to provide security for members of the population throughout their lives. Though there are many similarities between the three systems, there are also differences between the European Systems and ours that are worthy of note. The European systems like ours provide for retirement pensions, disability, and hospitalization/medical insurance. A significant difference is those systems provide substantially broader welfare benefits while at the same time tying pension benefits to worker-provided contributions.

The French system, in essence, is mandatory for all workers. Further, it is managed by a network of non-governmental offices. The French employer provides considerably greater contributions than does the employee--five times as much for health insurance, twice as much for retirement, and all (10.5% of taxable income) for "family benefits."²⁰

The French have a national health insurance program--in which the individual pays a small part (10-30%) of certain costs--that completely covers catastrophic costs. That system provides maternity insurance for mother and child protection of hospital expenses as well as pays cash benefits for 14 weeks. The employer must pay the costs of job injuries.

Disability pensions are based upon the percent of disability and the individual's wage at the time he or she became disabled. Old-age insurance is not entirely covered under the French system. But about 60% of the work force is enrolled in the program--the rest are covered by special plans of worker groups. Those covered under the social security Old-Age system can

expect a pension of 40% of their average wage of the last 10 years of their working lives if they retire at age 65--if they retire at age 60 (the minimum retirement age) they receive 20% instead. To attain these levels the worker must have a minimum 30-year wage history. Those with 15 to 30 years will receive a lowered pension. Those with 5 to 15 years will receive a pension of 10% of half the total contributions paid in their name. Those with under five years have their contributions returned to them.

The family benefits part of their system is purely welfare in nature. It is designed to encourage a higher birthrate in that it provides cash benefits to families based upon the number of children within. It pays a maternity allowance--half before birth and half after. Also, to keep the mother at home there is a single wage allowance and mother-at-home allowance.

The German system is closer to the American version than is the French in that it is managed by the government and is controlled by extensive governmental legislation. ²¹ It provides for reimbursements for certain welfare benefits, such as children's allowances, from Federal tax revenues. Unlike the French or American systems many features of the German system are related to post-World War benefits for those who formerly resided in now Communist-dominated areas, displacement allowances, and war-induced disabilities.

A particularly cogent difference between the German system and the other two is the retirement pension provisions. The German aim is to insure everyone has an income throughout their life. For the most part, they require everyone to contribute to one of three Federal pension plans--manual workers, non-manual workers, or miners' special scheme. They do allow those who can prove they have other lifetime retirement programs to withdraw from the Federal system. Should one who has withdrawn from the system because of this provision change employment,

he or she can reenter the Federal system--the prior employer must pay to the Federal Old-Age fund the amount that would have been contributed during the period. Another feature of import is the worker may elect to pay higher contributions to obtain a higher benefit on retirement--the benefit is determined actuarially the same as is one for a private pension. Widows (ers) receive the amount of the worker's pension when he or she dies. The German system is designed to allow the pensioner to maintain the standard of living to which he was accustomed during his working life rather than a reduced level as in the American and French systems--consequently, the benefits paid are higher.

COMMENTARY IN CONCLUSION

To this point you have been presented facts and not author opinion. Opinion now seems appropriate as a synthesis mechanism--recognize these opinions will reflect the author's biases and observations not necessarily conclusive fact.

It seems a central question that must be answered concerning social security for the future is: What do Americans expect of the system--a "generous pension for life" as the system was described in 1935-1936 or a limited pension designed to supplement savings and other investment income accumulated during one's working life, with an attendant set of welfare benefits? Should the American retiree simply accept a reduced standard of living from that which he had during his working life or that same standard of living, as his German counterpart can expect?

He or she can have both! Yet, that would require Congress to separate truly the insurance portion of the program from the welfare part. From the welfare side--as the recent Advisory Council recommended--Medicare (Federal Hospital and Supplementary Medical Insurance) should better become tax-related benefits in the form of a comprehensive national health insurance program for

all Americans. That program should protect all from the devastating expenses a catastrophic illness brings. Welfare-related benefits to the family of deceased workers are essential but they need not be provided by pension funds. They can be accommodated in a number of ways varying from redistribution of general revenues to pay the benefits, to the French method of taxing employers for these benefits. There is also the conservative opinion that contributions put in by the employee/employer, in an estate sense, should be available in a lump-sum as a probate award to survivors or as a supplementary annuity to their own pensions on the occasion of their retirements.

Disability is properly an insurance benefit. As the French conclude, there are degrees of disability that warrant varying portions of one's current wages based upon the degree of lost earnings. However, there is no reason to tie disability to pension programs. Perhaps employers, as in the French system, should provide a greater portion to this insurance than employees since disability relates to lost wages. Merging state Workman's Compensation with the current Federal disability insurance seems reasonable since combined benefits allowable are already used in computing maximum disability payments.

The pension system, too, properly is an insurance program. It could easily be employee-regulable as is the German program. If that feature is deemed unimportant standard, fixed contributions by employees and employers as a percentage of income either in a matching or unequal proportion could finance the pension program sufficiently to insure outputs to at least those of current private and semi-public plans. However, such a program is impossible if the intent is for "revenues to approximately match expenditures" which causes the projected liquidity crisis facing today's system. Needed is a program that can accumulate quantities of investment funds to provide a compounded reserve in pension accounts sufficient to provide today's worker an adequate retirement income in the future. For the American to have little or no reduction in his standard

of living upon retirement, or for an assurance his surviving spouse will not be forced to sell their hard-earned assets to survive, he must know what he contributes today will be available in the future for his or his wife's betterment and that the system will not face bankruptcy because of more "outgo" than "income." The American must be assured the "indemnity contract" he is pursuing today will be available when he retires. Given that, he will more readily pay higher contributions if they are needed to finance his future retirement.

Can this be done under government auspices? Certainly, but one risks the problems that have led at least in part to the current crisis--(1) welfare drains of non-welfare contributions from a Congress that in good faith, but not always in full awareness of the consequences, attempts to care for the "security" of the people they represent by hiding popular social expenditures that should be financed with unpopular taxes in an insurance program; and (2) a bureaucratic governmental organization that thrives on minute definitions, detailed regulations, and a peculiar jargon that befuddles the people it serves. The current system manages both insurance and welfare programs--the consequences, as one can see, are a convergence of the two. Perhaps a better solution is a semi-private corporation(s) to manage pension and/or disability insurance programs. The U. S. Postal Service provides a successful model of such an enterprise. The goals of such a semi-private system should be: (1) reduce and simplify the rules so Americans can understand them, (2) generate sufficient investment income so Americans can expect no reduction in standards of living on retirement, and (3) maintain Congress as an "arms-length" auditor rather than as an "operating director." Such a solution may solve the institution's crisis which is in reality a crisis of American worker expectations.

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