

UNIVERSAL SOCIAL SECURITY COVERAGE: EXTENDING MANDATORY COVERAGE

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AUTHOR:

Dennis Snook

Education and Public Welfare Division

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ISSUE DEFINITION

"Universal social security coverage" refers to a variety of issues resulting from the existence of employment not covered by social security. Of current interest are those Federal, State and local, and private, nonprofit jobs which are not protected by, and not taxed for, the provisions of the social security program. Eliminating opportunities for noncovered employment could correct certain disparities in the treatment of workers, improve the financial operation of the program, and result in a short term infusion of revenue to the Social Security Trust Fund.

Universal coverage would precipitate substantial restructuring of complicated retirement systems, and entail additional costs for many government and nonprofit employers. Representatives of governmental employee groups believe that this redesign of public pension plans, and the strain on cost-conscious governments of paying the employer's share of the social security tax, will mean serious cutbacks of retirement rights and income protections that noncovered employees have acquired during the years of their exclusion from social security. Opponents of mandatory coverage of Federal workers also argue that any short term financing assistance to social security resulting from coverage is illusory, and is actually a reliance upon general revenues to fund a portion of the program benefits.

BACKGROUND AND POLICY ANALYSIS

Current Law

Covered employment is employment in which earnings are taxed for social security and in which the income protection of the program is acquired. Currently, 90% of the workforce in the United States works in employment covered by social security. However, most employment in the Federal Government, about one-third of the employment in State and local governments, and about one job in eight in private, nonprofit organizations is not covered by the retirement, survivors, disability, and hospital insurance programs.

In addition, certain kinds of marginal employment remain excluded (some newspaper vendors, students employed in their schools, and family members working within the domicile). Although the exact number of noncovered workers is unknown, estimates produced for the Universal Social Security Coverage study indicate that between 6 and 7 million employees would be affected by expanding coverage to include all government and private, nonprofit employment. NOTE: This study, mandated by the 1977 Amendments to the Social Security Act, was charged with determining the "desirability and feasibility" of extending social security coverage to all Federal, State and Local, and private, non-profit employment. The report of the Universal Social Security Study Group was released in March 1980.

The major groups not covered are:

A. Federal civilian employees covered under another U.S. retirement system. By far the greatest number of these employees are covered by the Civil Service Retirement System. Federal employees covered by social security include those in the armed forces, Tennessee Valley Authority (TVA), nonappropriated fund activities, and other quasi-Federal organizations.

B. Employees of State and local governments who have not been covered by a Federal-State agreement. About two-thirds of State and local employees are covered because their employers have entered into voluntary agreements to provide such coverage. These agreements can, within certain restrictions, be terminated.

C. Employees of certain nonprofit organizations that have not arranged for social security coverage for their employees. Organizations tax-exempt under 501(a) of the type described in 501(c)(3) of the Internal Revenue Code may cover their employees through voluntary agreements. About seven of every eight regular jobs in nonprofit organizations are presently covered. These agreements can, under certain conditions, be terminated.

Problems of Non-Covered Employment

Certain problems result from the existence of noncovered employment. Under current law, employees who move between jobs covered by social security to those not covered or vice versa may experience periods without income protection for themselves and their dependents in case of death or disability, may not build adequate credits toward retirement pensions, and may actually forfeit any return on contributions. Some employees, on the other hand, acquire benefits from social security under especially favorable conditions, and yet receive full benefits from a public staff pension plan. Underlying these individual and structural problems is a fundamental question: Under what conditions are exemptions warranted from a program that requires mandatory participation for most citizens and that fulfills certain social objectives?

History

When the social security program originated, primary and immediate attention was directed to covering employees in commercial, nonagricultural enterprises. Many of those employees excluded from participation were already eligible for some form of income protection, or were engaged in employment not readily assimilated into a beginning social insurance program. Since its enactment in 1935, social security has been marked by incremental expansions of coverage and of changes in the type and generosity of benefits provided. The program currently provides benefits to over 35 million beneficiaries.

Recommendations to mandate social security coverage for all noncovered employment are as old as the system itself. Over the years, none of the various reports and studies which have examined the issue of mandatory coverage for all public and private nonprofit employees has resulted in options acceptable to Congress.

An option to join under voluntary agreements was provided in 1950 to private nonprofit organizations; it was thought at the time that the goal of providing needed income protection without endangering tax exempt status could best be accomplished in that fashion. Under these agreements, if an organization decided to join, employees voting against coverage were not included in the coverage agreement but all new employees were covered automatically.

Also in 1950, State and local employees not covered by a retirement system sponsored by their employer governments were provided an opportunity for social security coverage, if their employer elected such coverage, and if

their State had entered into an agreement with the Federal Government to permit such coverage. In 1954, State and local government employees (except policemen and firemen), under a retirement system were permitted to elect coverage. In 1956, firemen and policemen in designated States were permitted coverage. Also, in 1956, some States were granted the option for coverage purposes of dividing an existing retirement system into two systems, one excluding employees not desiring coverage, and the other integrating social security coverage into a new system. The new system was to include all employees electing coverage and any employees hired after the effective date of coverage. In 1957, coverage was extended to the uniformed services.

During the initial stages of development, the 1977 Amendments to the Social Security Act contained a provision that would have extended social security coverage to the remaining noncovered government and nonprofit employees. This provision was deleted during consideration on the floor of the House of Representatives. In its place, Congress directed the Department of Health, Education and Welfare (DHEW) to conduct a 2-year study of the desirability and feasibility of covering currently noncovered public and private, nonprofit employment. The Universal Social Security Coverage Study Group released that report in March 1980. The report made no recommendations (although its chairman publicly endorsed coverage of these noncovered employees), but did contain substantial empirical data on the consequences of permitting some employment to remain outside the social security program. The report also contained several options for action on the issue.

In addition to the Universal Coverage Study, three other government sponsored studies have commented on this issue in the past year. The 1979 Advisory Council (a group of citizens and experts established regularly to assess the social security system and recommend changes) endorsed social security coverage for Federal, State and local, and nonprofit employees. The President's Commission of Pension Policy and the National Commission on Social Security, two ad hoc groups set up to study and report on issues in the Nation's retirement income programs, have recommended in their interim reports that serious consideration be given to mandatory coverage for these noncovered employees.

Another group, the Fund for Assuring an Independent Retirement (FAIR), opposes universal coverage. This group, organized and supported by groups representing public employees and annuitants, also commissioned a study of universal coverage. The report from that study asserts that in order to insure equitable treatment of employees, no employee should receive less than would have been received had no changes been made. Not only would this be expensive, the report argues, but the necessary program restructuring required to integrate social security coverage with currently noncovered retirement plans would introduce "unnecessary confusion and unwarranted complexities," and accomplishes no significant purpose.

Social Security as a Compulsory Program

The program was compulsory for its first participants and most subsequent expansions of coverage have been mandatory. One justification is based upon the relationship of benefits to financing; only by requiring participation of both high and low cost participants can benefits be adequately financed. Another justification for compulsory participation follows from the observation that, because of the pressure of immediate economic demands, most people are unable or unwilling to prepare adequately themselves or their dependents, for income loss due to retirement, death or disability. Social philosophers, in advocating social insurance programs, argue that the nature

of social insurance is compulsory: a voluntary government income replacement program would not differ in substance from the array of savings and insurance opportunities available in a free economy. Only by requiring participation can society be protected from the undesirable effects of destitution among citizens who are not expected to work because of old age, disability, or dependency. Social insurance provides both an income in retirement and an income insurance against unforeseen catastrophes. Consistent with these social objectives, the program began paying benefits to early participants in spite of the relatively short span of employment in which they contributed.

Comparing Social Security and Staff Pension Plans

Many public servants, especially Federal employees, receive relatively high retirement benefits, but these same employees often receive less generous disability, survivors and inflation protection than is offered by the social security program. As a general rule, most employees covered by both staff pension plans and social security have broader income protection with higher benefits than employees covered by a staff pension plan alone. One major exception must be noted. Most public pension plans permit employees to retire under a full pension before age 62, the earliest age of social security old age retirement. Many public staff plans permit retirement at age 55 after 30 years of service. Policemen and firemen often retire at age 50 or younger with 20 years of service. As a consequence, employees with full careers covered by staff retirement plans often acquire the protection of social security after qualifying for benefits in a noncovered plan. The report of the Universal Coverage study claims that as many as three out of every four Civil Service annuitants eventually may qualify for a social security benefit. In addition, because of the criteria by which social security establishes eligibility, many employees retain or acquire social security insurance protection while employed in noncovered jobs, protection earned by prior or concurrent employment covered by social security.

Social security is most often referred to as social insurance; it is designed to replace earnings lost due to retirement, death or disability and is financed by a payroll tax on both employers and employees with benefits granted by entitlement. Retirement benefits are earned through accumulation of quarters of covered earnings; disability and survivors protection is earned the same way, only more quickly. Full benefits are paid at age 65; a reduced benefit is available at age 62. Benefits are related to earnings which are adjusted to current values before benefits are calculated. Benefits are tilted in favor of recipients with career histories of low wages. There are comprehensive medical benefits available in the program. Additional benefits are granted to dependents. Earned credits are fully portable from one covered job to another. Benefits are tax free and adjusted annually for changes in the cost-of-living.

Civil Service Retirement is a staff retirement plan, financed by employee contributions and government general fund payments, with benefits available upon reaching a combination of years of service and age; most employees retire before age 60 with more than 25 years of service. Benefits are calculated according to salary and years of service -- longer service means a higher percentage of salary replaced and higher salary means a higher annuity. There are benefits for survivors of deceased employees. Benefits for survivors of annuitants are available but cause lower annuities. Disability benefits are paid; however, there is no allowance for dependents except in the case of work-incurred disability. Retirement credits are transferable only with Federal employment. Annuities are taxable after the

employee has received the value of his contribution in payments; generally around 18 months after benefits commence. Annuities are adjusted annually for changes in the cost-of-living.

Public' employee retirement systems of State and local governments vary in average size and type of employee covered. Of the approximately 6,000 plans, about 3% cover about three-fourths of the workers. Two-thirds of all plans are local police and firefighters, but the total membership of these plans represents only about 3% of all State and local government employees.

In general, State and local government pension plans coordinated with social security are not much different from plans for employees not covered by social security. However, retirees who acquire social security benefits after becoming eligible for benefits from their staff retirement plan may receive total retirement pay greater than employees with coordinated coverage. This may be especially true for police and firefighters. Typically, these employees retire at age 50 or 55 with 20 years of service and often can retire at any age with 20 years of service. Many of these employees have second careers under social security covered employment.

Much noncovered nonprofit employment is volunteer, and/or irregularly compensated. Pension protection, if available, is usually a defined contribution plan with benefits based entirely on contributions (and any accumulated interest on those contributions) made during participation.

Relationship Between Noncovered Employment and Social Security

Most noncovered workers are participants in staff retirement plans sponsored by their employers. Four major consequences follow from the existence of employment not covered by social security but covered by staff retirement plans:

- (1) Some employees may experience periods without income protection as they move between jobs covered and not covered by social security. These periods without income protection occur because both social security and typical staff plans require that employees work a specified period of time prior to becoming protected by disability, survivor, and certain other provisions of their respective programs. In addition, typical staff retirement plans often lack some of the features of social security. Benefits for disability, survivors, and dependents, as well as full cost-of-living adjustments, and comprehensive medical benefits are features of social security generally superior to similar provisions of staff plans.
- (2) Some workers pay into social security without becoming eligible for any benefits. These workers receive no return on their social security contributions. Some workers also leave noncovered employment without retaining any pension rights, and could reach retirement age without an adequate source of retirement income. These first two consequences have been called coverage or benefit "gaps."
- (3) Some employees who spend only a portion of their work

career in employment covered by social security acquire benefits from the program under especially favorable conditions. These so-called "windfalls" are a product of the methods by which social security benefits are computed under present law. The present formula is highly favorable to those with low earnings. This feature of the program is designed to alleviate the economic wants that might otherwise result from giving equal treatment to earnings regardless of how high or low they are. However, "low earnings" may result from short term work in covered employment coupled with a fairly long tenure in noncovered work -- work in which a substantial retirement benefit is earned. The result is an unintended subsidizing of social security benefits for those whose low earnings do not represent a situation of economic need. In addition, because of a feature in the computation intended to disregard up to 5 years of exceptionally low wages before benefits are calculated, workers with a nearly full career of covered earnings, but some noncovered earnings, can have the same benefits as someone who has contributed to social security 5 years longer. This is known as a "contribution gap."

- (4) Workers in noncovered employment are exempt from the taxation that supports the social objectives of the social security program. This tax burden is mandatory for all workers who are not exempt from participation.

Mandatory social security coverage for currently noncovered workers could eliminate an estimated \$840 million yearly in windfalls and unintended subsidies, and could result in additional revenues of an estimated \$1.1 billion from elimination of contribution gaps, according to the DHEW Universal Coverage Study.

Impact on the Social Security Trust Fund of Universal Coverage.

Eliminating opportunities to work in noncovered employment has additional short-run implications for the financial condition of the social security program. If all currently noncovered workers were covered beginning in 1982, the office of the Actuary of Social Security estimates that \$22.5 billion in additional revenue would flow to the Social Security Trust Fund by 1985. Over a generation, this surplus of revenue over benefit payments would diminish. Revenue surplus occurs early in the transition to full coverage because employee/employer contributions would be paid in the full amount immediately, while benefit obligations would not come due until employees began to retire, or otherwise became entitled to benefits.

TABLE 1. Additional OASDI and HI contribution
income resulting from universal coverage

(In calendar years after the effective
date through 1990)
(in billions)

New entrants only

Calendar year	Total	Federal	State and Local	Nonprofit
<u>Effective Jan. 1, 1982</u>				
1982	\$ 0.7	\$0.4	\$0.3	(1)
1983	2.4	1.2	1.0	\$0.2
1984	3.9	1.9	1.7	0.3
1985	5.8	2.8	2.6	0.4
1986	7.8	3.8	3.5	0.5
1987	10.0	4.9	4.5	0.7
1988	12.5	6.1	5.5	0.8
1989	15.3	7.5	6.8	1.0
1990	20.1	9.6	9.1	1.4
<u>Effective Jan. 1, 1985</u>				
1985	1.0	0.5	0.4	0.1
1986	3.3	1.7	1.4	0.2
1987	5.4	2.6	2.4	0.4
1988	7.6	3.7	3.4	0.5
1989	10.1	4.9	4.5	0.7
1990	13.8	6.8	6.1	0.9

(1) Less than \$50 million.

All current and future employees

Calendar year	Total	Federal	State and Local	Nonprofit
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Effective Jan. 1, 1982

1982	\$15.6	\$ 8.7	\$ 5.9	\$1.0
1983	17.8	9.6	7.1	1.1
1984	19.6	10.6	7.8	1.2
1985	22.5	12.2	9.0	1.3
1986	24.9	13.5	9.9	1.5
1987	27.1	14.7	10.8	1.6
1988	29.5	16.0	11.7	1.7
1989	32.1	17.5	12.7	1.9
1990	37.4	20.5	14.7	2.2

Effective Jan. 1, 1985

1985	21.4	12.2	8.2	1.3
1986	24.9	13.5	9.9	1.5
1987	27.1	14.7	10.8	1.6
1988	29.5	16.0	11.7	1.7
1989	32.1	17.5	12.7	1.9
1990	37.4	20.5	14.7	2.2

 Note: Estimates are based on the July 1980 Mid-Session Review assumptions through 1984 and extended through 1990.

Source: Social Security Administration, Office of the Actuary,
 July 29, 1980.

Of course, it is unlikely that a universal coverage proposal could be effective for all new and current employees in 1982 -- some employees (say, employees eligible to retire) would likely need to be exempted. State and local governments would need several years lead time to manage the various complexities of retirement system redesign and development of any required alternative financing. Table 1 shows short term revenue gains in various combinations of effective dates and affected employees.

Some analysts believe that the social security program is faced with potential cash flow shortages in the near future. Any such cash-flow shortage would require a payroll tax increase, a benefit cut, or the use of a new revenue source into the Social Security Trust Fund. The short term infusion of revenue from extending coverage to previously noncovered workers could alleviate the problem, although not in the same sense as either a tax increase or benefit cut.

Mandatory Coverage for Public Employees

If the decision were made to proceed to universal coverage, Congress could cover public employees by amending the Social Security Act; such an amendment would precipitate restructuring of affected staff retirement plans. These modifications would be required to assimilate the features of social security into the structure of income protection public employees currently possess.

There are three major considerations in coordinating staff plans with social security:

(1) The Benefit Package Would Need Redesigning. This redesign would include changing the benefit formula to either implicitly or explicitly consider the value of expected social security payments; i.e., benefits could be offset by each other or added together. In either case, an appropriate level of combined benefits is a determinable policy choice. However, if the social security formula itself were not modified, it would be necessary to determine the effect the social security "tilt" to lower earnings would have on the coordinated pension plan benefits.

One objective might be to replicate in the coordinated plan any benefits that would have been earned under the old staff plan. Major problems are encountered in trying to replicate benefits before and after coordination. Social security benefits are not taxable; certain ancillary benefits of social security vary with family composition; length of employment in jobs covered by the coordinated system would vary. Each of these factors would vary the degree to which the current social security benefit formula would affect the relationship between the staff benefit and the social security benefit.

A strategy replicating current staff plan benefits while coordinating the plan with the current social security structure is theoretically possible. A 100% offset of any social security benefits earned in employment covered by the staff plan would permit benefit replication and would completely neutralize the distributional effects of the social security benefit tilt. However, establishing the appropriate portion of social security to be offset would be administratively difficult; the formula itself would be cumbersome and would require benefit payment information not presently available. There is some risk that the "100% offset" technique would result in low income employees receiving most of their retirement income from social security and few or no benefits from the staff plan, while higher income workers would

receive a larger proportion of higher total benefits from the staff plan. Under such a structure, the staff retirement component could be made attractive to high income, long term employees, but lower income or short term employees would not receive the same staff plan annuity value for each year of service as their higher paid co-workers. Internal Revenue Service regulations prohibit private staff pension plans from fully neutralizing the social security tilt in the staff plan benefit formula, although these IRS regulations do not necessarily apply to government plans.

Because of the social security benefit tilt to lower earnings, a formula that seeks to duplicate as closely as possible retirement benefits earned under the current pension format, and that maintains the social security tilt, would have to target the intended post-retirement replacement rate to a particular preretirement salary level. Under any formula that maintains the social security tilt, employees whose income is less than the target salary would receive benefits greater than the current replacement rate for the target salary -- employees with higher salaries, less. An additional supplement, or "thrift plan." could mitigate this loss to higher paid employees.

Ancilliary features, e.g., medical, disability, survivors or dependents benefits, could be modified or eliminated to accommodate overlap that might result from providing social security coverage as well as the provisions of the staff retirement plan. Plan sponsors could also look upon the restructuring as an opportunity to modify the plan in ways not necessarily caused by social security coverage.

(2) Some Current Employees Might Need to be Exempt from the Transition to Coverage. If the decision is made to extend social security to currently non-covered employment, this would seem to promote including as many current employees as is feasible. Data developed by the Universal Coverage Study suggest that most current employees could be covered with no reduction in current benefit expectations. However, many analysts have argued that for political and other reasons only new employees or employees who have not yet acquired vested benefit rights should be required to participate in any coordinated system. In all cases, benefit rights earned under old rules could be frozen and combined with benefits earned under new rules.

One transition option frequently mentioned as a possibility, and currently available to State or local plans entering social security, is to include all new employees under the coordinated plan and provide an option to participate to all current employees. This strategy could be combined with actions intended to close coverage gaps and diminish windfalls.

(3a) Coverage of Federal Employees May Have Cost Implications. To assess accurately the extent to which universal coverage would affect taxpayers requires further analysis of the complex interrelationships in pension rights and social security entitlements earned by all current noncovered employees.

As previously illustrated, in the short run mandatory coverage would improve the financial condition of the social security system. The near-term additional revenues would exceed the near-term additional expenditures. Over the long term, improvement in the financial operation of the social security programs would result only if the savings from eliminating windfall benefits and contribution gaps exceeds the costs of bringing new participants into the social security system. The social security actuaries estimate that there would be an average long term (75 years) advantage to covering all currently noncovered public and private, nonprofit employees. The actuaries estimate

that the savings to the social security program would be equivalent to roughly .5% of taxable payroll.

The short term effect upon the unified Federal budget is roughly the same whether coverage is extended or not. Federal outlays for both social security and civil service retirement benefits reflect rights earned some years prior to the commencement of payment. These rights would continue to be honored; consequently outlays for benefits would continue as before. While the Federal Government would now be a contributor to the social security system, in addition to paying the continuing costs of the existing Civil Service Retirement System, this transaction would be internal, that is, it would be an intergovernmental transfer of funds resulting in no new revenues or expenditures to the Federal Government.

In the long run, the benefit obligations of the Civil Service Retirement System would be reduced if social security coverage were provided Federal employees. In a written response to a question submitted by the House Post Office and Civil Service Committee, the DHEW Universal Coverage study group suggested that any long term changes in Federal pension outlays would "depend on the generosity of the coordinated system",

However, there is a different way of viewing the implications on the Federal budget of covering Federal workers by social security. There are basically three possible methods of improving the financing of the Social Security Trust Funds: payroll tax increases, benefit reductions, or new sources of revenue. An expansion of coverage to include noncovered State and local employees is a new source of Federal revenue. Coverage of Federal workers, however, is not the same sort of revenue infusion: employee contributions currently going to the Civil Service Retirement Fund would be redirected to social security; the employer's share of the social security tax would likewise come from within the Federal budget. While these are new revenue sources for social security they do not constitute additional revenues to the Unified Federal budget.

If mandatory coverage is motivated in part by the desire to improve the financing of the social security system, then it diminishes the need to use other means to strengthen the social security system which would increase Federal revenue (e.g., through a payroll tax increase) or reduce Federal expenditures (e.g., through benefit deliberalizations). These alternatives would affect the Federal deficit (or surplus, if it existed). Although different in form, mandatory coverage of Federal employment has the same implications for Federal fiscal policy as direct general fund financing of social security -- it does not bring additional revenues into the Federal Government.

(3b) For State and Local Governments, Some Additional Costs May Be Entailed.

Most State and local employees contribute to their pension plans. If social security is expanded to include these employees, the social security tax may be considered too great an additional tax burden on them, and the amount employees contribute to the staff retirement plan might be reduced. In the long run, some of this loss in revenue would be offset by the lower costs associated with replacing a portion of the staff plan benefit by social security. At the same time, any additional long run costs would be a result of improvement in the employee benefit package.

During the period of the transition, however, coverage could result in a

net increase in sponsor expenditures for employee income protection. For instance, a plan that, upon coordination, foregoes employee contributions from all new employees would gradually decrease the ratio of employees contributing to those not contributing. However, benefit rights accrued by current annuitants and employees would continue through the attrition under the old plan of all eligible beneficiaries.

The smaller staff plan benefit earned by new employees would not result in reduced plan costs until those employees reached retirement age. Thus, the net result to the plan is a diminishing source of revenues in the period of transition with a reduction in benefit obligations not occurring for some time. In addition, the sponsoring political entity would be responsible for the employer's share of the social security tax. This burden would increase as the ratio of employees covered to those not covered increased.

For some sponsors, outlay costs probably would rise, at least for a few years. For instance, plans that have been in existence long enough to acquire a generation of participants, and that make payments to beneficiaries from current operating revenues, would face a long period during which these payments would continue at levels earned prior to coordination. At the same time, the sponsoring employer would acquire the additional burden of paying the employer's share of the social security tax for any covered employees. These government employers might require some advance notice before mandatory social security coverage became effective in order to develop a fund through which flexible financing of benefit obligations could be arranged.

For plans already practicing some form of advance funding, the additional costs entailed by social security coverage may be more easily managed. Plans that invest some revenue from any employee or sponsor contributions develop a pool of assets that partly fund pension benefits in advance of their receipt. These plans could, for a limited period of time, forego a portion of their current investment rate. While this would result in some deterioration in the ratio of assets to benefit liabilities, and in some cases may even result in a reduction in the investment portfolio itself, the additional burden of the employer share of the social security tax might be managed without substantial increases in sponsoring government outlays.

Alternatives to Coverage

Alternatives to mandatory social security coverage for noncovered employees that attempt to meet objections to the present situation have been discussed. Each of the four alternatives discussed below would diminish or eliminate at least some of the four problems mentioned earlier. None would alleviate all of the problems. All have serious policy implications if enacted separately. A combination of these alternatives designed to treat all of the problems possibly would be as complicated and controversial as (and possibly less effective than) universal coverage itself.

Establishing Federal minimum standards for staff pensions could help reduce coverage gaps. These minimum standards would have no effect upon windfalls. State and local governments may resist Federal authority to mandate pension plan standards for public employee retirement systems.

A system for transferring credits between social security and noncovered retirement systems could be developed. Transfer schemes currently under discussion would diminish coverage or

benefit gaps, but could be expensive, complex, and probably incapable of satisfying the objective of combining pension protection earned in all covered and noncovered employment..

A method for "offsetting" or reducing social security benefits earned by employees with portions of their career in noncovered employment is possible, and could greatly diminish windfalls. An effective method might require revisions in social security, might adversely affect employees with second jobs, and would not eliminate coverage and benefit gaps.

The social security system could be revised. If the program became voluntary or established a strict relationship between contributions and annuities for all workers across all categories, problems created by the existence of noncovered employment would diminish considerably. This strategy would constitute a major departure from the current social security program and could encounter political resistance.

Several alternatives to mandatory social security coverage of noncovered employees might attract support from groups opposed to coverage and the staff plan modifications coverage entails, but willing to accept a proposal diminishing opportunities for windfall benefits. Several of these alternatives address the problem of windfall benefits but leave the basic structure of employee benefits intact. These alternatives generally focus on the social security formula, revising it in such a way as to diminish the advantages received by workers with fairly low career totals of covered earnings derived from employment other than in their primary noncovered employment. Such a move attacks the essence of windfalls -- weighted benefits intended for low income workers received by workers with much higher incomes from noncovered public employment. To the extent that these strategies are successful the financial operation of social security would be improved. It is worth repeating, however, that these revisions to social security would not solve all problems created by the existence of non-covered employment and might result in detrimental effects to some truly low income workers with dual employment.

Problems Encountered by a Mandatory Coverage Plan

Developing a rational system of income protection is a difficult project under the best of conditions -- attempting to restructure an existing system amidst various pressures and constraints is even more difficult.

The task of establishing a new benefit formula, which on the one hand respects the benefit tilt of social security, and, on the other, maintains total benefits at current levels is a problem, given that most staff retirement systems provide, for employees with the same number of years of service, a gross income replacement rate constant across all income levels. This problem is further complicated because post-retirement income is generally less than pre-retirement income and is thus taxed at a lower rate; that portion of post-retirement income paid by social security is not taxed at all. The net replacement rate is thus significantly affected by the substitution of nontaxable social security benefits for a portion of taxable pension benefits. As a consequence, net replacement rates are exactly replicable only in some cases, although formulae can be developed that assure all affected employees at least as much as the currently entitled or that provide higher replacement rates for employees with relatively lower final salaries.

No less important is the very popular feature in many public pension plans of a retirement age earlier than the age 62 minimum for social security benefits. It may be impossible to maintain benefits at levels equal to those paid under a noncovered plan if this relatively early retirement were retained following coordination with social security. If employees could continue to retire at 55 but would not receive the social security portion of their benefits until 62, then early retirement benefits would be less after coordination, or some pre-62 supplement would be required.

The primary solution offered -- the level life supplement -- presumes a supplement in addition to the staff plan benefit. This supplement would be roughly equal to the expected social security benefit payable at age 62 and would continue from the commencing date of the staff plan annuity until the age at which social security benefits actually would begin.

A major drawback exists to the level life supplement. In a staff retirement system, benefits usually are paid when an individual reaches the age of retirement eligibility and retires, regardless of whether or not that individual acquires employment with some other employer. Under social security, an age 62 social security recipient can earn no more than \$4,440 in 1982 without losing benefits. After that amount, benefits are reduced one dollar for each \$2 in earnings. If the supplement were paid to workers retiring at age 55 and discontinued at age 62, some retirees who secured other employment after retirement from Civil Service would face an income reduction at age 62. These annuitants would, upon reaching age 62, lose their supplement, and, if they earned more than the amount permitted in the social security retirement test, would also have their social security benefit reduced. Therefore, these annuitants would be cut at age 62.

Another solution to the problem of benefit disparities created by coordinating social security with pension programs having earlier retirement ages is to have all retirement ages the same as those of the social security program, or simply grant far fewer benefits for early retirement. Many analysts are arguing that retirement ages are too low generally and that even social security should have a higher age of eligibility. The issue of the proper role of an age requirement for retirement eligibility is quite complex, raising as it does questions about common expectations in groups with differing longevity, involuntary separation of late career employees, the circumstances of a future economy, differences in job attractiveness and compensation, and the appropriate relationship between workers and nonworkers.

Serious attention is, however, being paid retirement age questions. The President's Commission on Pension Policy, in addition to endorsing the proposal to raise the social security retirement age, recommended raising the normal retirement age for Federal employees to age 65, with actuarial reductions for earlier retirement. Such a proposal is certain to meet vigorous resistance from Federal employees.

Mandatory social security coverage for nonprofit enterprises may present special problems. Under current law, religious, charitable, or other tax-exempt organizations of the type described in 501(c)(3) of the Internal Revenue Code can be covered by social security on a voluntary basis if they waive their exemption to the social security tax. Replacing the opportunity for voluntary agreements with mandatory coverage would raise serious questions concerning the nature of the present exemption.

The Constitution clearly accords a measure of protection from government involvement in religious activities, and certain other nonprofit activities may also claim special status. While it is unclear where the boundaries of this freedom lie, there appears to be some reservoir of immunity from government interference, at least for religious activities and possibly for all nonprofit enterprises meeting the definition of a 501(c)(3) organization.

Very little information exists on noncovered nonprofit employment. Much of the noncovered, nonprofit employment appears to occur in organizations of short duration or limited constituency. Spontaneous religious activities and altruistic secular enterprises are often marginal economic entities. These "free associations" arise independent from government contact and could dissolve if faced with government involvement during the initial stages of development. Often such loose or eccentric organizations are generated from the enthusiasm of a small group of dedicated individuals, and disband when enthusiasm wanes -- an income source depleted, a goal met, an idea exhausted.

By far the greatest number of regular jobs in nonprofit organizations are in the established and enduring institutions. Most private schools, religious or charitable organizations and hospitals, for instance, already are covered by social security on a voluntary basis.

Proponents for mandatory coverage for nonprofit enterprises, in addition to citing the aforementioned arguments in favor of extending social security to currently noncovered employees, suggest that the uncertain nature of much of nonprofit employment amplifies the need for the income protection features of the social security program.

Opponents of mandatory coverage for nonprofits argue that little additional coverage would be gained, that the administrative difficulties imply that substantial effort and expense would be required to secure coverage, and that substantive constitutional grounds may exist to continue the exemption nonprofits currently enjoy.

Legal Questions Raised by a Proposal to Mandate Social Security for all Federal, State and Local, and Private, Nonprofit Employment

Even if all administrative and program design problems can be overcome, and social security is extended to currently noncovered public and private nonprofit employment, certain legal challenges are possible.

There seems to be no disagreement with the view that the Federal Government may legally mandate social security coverage for its employees. Some disagreement does exist, however, as to whether the Federal Government may modify existing pension agreements to accommodate such coverage.

As a general proposition, Congress has the authority to alter provisions of Civil Service Retirement. It appears, however, that Federal employees have a vested right in their contributions to the Civil Service Retirement fund, and Congress may be restricted from adversely affecting such property rights. No proposal exists that would transfer the accumulated contributions of CSRS participants to social security. Civil Service retirees may also have a vested right to benefits after retirement has commenced; if so, the courts may rule that employees eligible to retire or nearing retirement may have some right to retire under current provisions.

An unbroken line of Supreme Court cases holds that Congress may modify

government pension entitlements to meet changing needs. Within constitutional limitations Congress may "revise, modify or recall" future benefits of the Civil Service Retirement Act. It would also appear that classification of current employees by age and/or service for the purpose of exempting some and including others in the development of a coordinated system is permissible provided a legitimate purpose is served by such a distinction.

For further discussion of the legal issues see the C.R.S. Report entitled "Constitutionality of Legislative Modifications of the Social Security Act and the Federal Civil Service Retirement Act," by Kathleen S. Swendiman (American Law Division), Feb. 27, 1979.

The question of whether Congress can legally mandate social security coverage for employees of State and local government remains unsettled. The United States Supreme Court's decision in National League of Cities v. Usury, 426 U.S. 833, is relevant to any analysis of Congress' power to mandate coverage for State and local employees. In that decision that Court set forth the view that State sovereignty is a limitation on the Commerce power, and that Congress may not "displace the States' freedom to structure integral operations in areas of traditional governmental functions." Thus, Federal regulation of State activities must be assessed to determine if it unduly interferes with those functions that a State performs in its sovereign capacity.

Opponents of mandatory coverage contend that such legislation interferes with State sovereignty on at least three grounds: (1) State and local governments have some measure of immunity from Federal taxation, in this case, the employer share of the social security tax; (2) mandatory coverage would impermissibly involve the Federal Government in the States' power to structure employer-employee relationships; and (3) mandatory coverage would create a financial burden upon certain State and local government functions.

Proponents of mandatory coverage point out that Congress has enacted and the Supreme Court has upheld legislation that imposes income taxes on State and local government employees, and that while limits do exist on the power of Congress to impose taxes on States, the Constitution does not necessarily prevent application of the social security tax to governments as employers. Proponents of mandatory coverage also argue that coverage does not interfere with States' rights to structure employment and wages, but merely requires government employers to comply with an important Federal program. In short, proponents assert, mandatory coverage would be upheld by the Court if it could be established that mandatory coverage is a compelling Federal interest, a claim that would no doubt be strengthened if it could also be demonstrated that the specific mechanism to bring about such coverage did not involve an excessively burdensome cost upon State and local governments.

Mandatory coverage of private nonprofit religious and charitable enterprises constitutes removal of an exemption these organizations currently possess. That exemption may be an exclusion based on administrative convenience, but might also be based upon more substantial constitutional grounds. The First Amendment protection granted to religious activities and free associations might be interposed as a defense against mandatory coverage of private, nonprofit employment.

LEGISLATION

H.R. 1018 (Conable et al.)

Repeals the increases in the contribution and benefit base enacted by the Social Security Amendments of 1977. Amends the Internal Revenue Code tax rates for employers, employees, and self-employed individuals to (1) increase the tax rate for coverage under Title II (Old Age, Survivors and Disability Insurance) of the Social Security Act; and (2) reduce the rates for hospital insurance benefits under Title XVIII (Medicare) of the Social Security Act. Amends Title II to: (1) include Federal employees within the coverage of such title; and (2) establish a working spouse's benefit. Introduced Jan. 22, 1981; referred to more than one committee.

S. 2905 (Stevens)

Civil Service Reform Act of 1982. Completely restructures civil service retirement system by covering Federal employees by social security, establishing a fully-paid-by-employer "defined contribution" pension, and adding a voluntary "thrift plan" with matching government contributions. Also replaces the present sick-leave disability configuration with a new one providing for distinctions between short and long term disability. Provides that all new employees would be brought in under the new system and incentives for voluntarily joining are provided to current workers. Introduced Sept. 14, 1982; referred to Committee on Governmental Affairs.

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