

GAO

Testimony

Before the Commission on the Social Security Notch Issue

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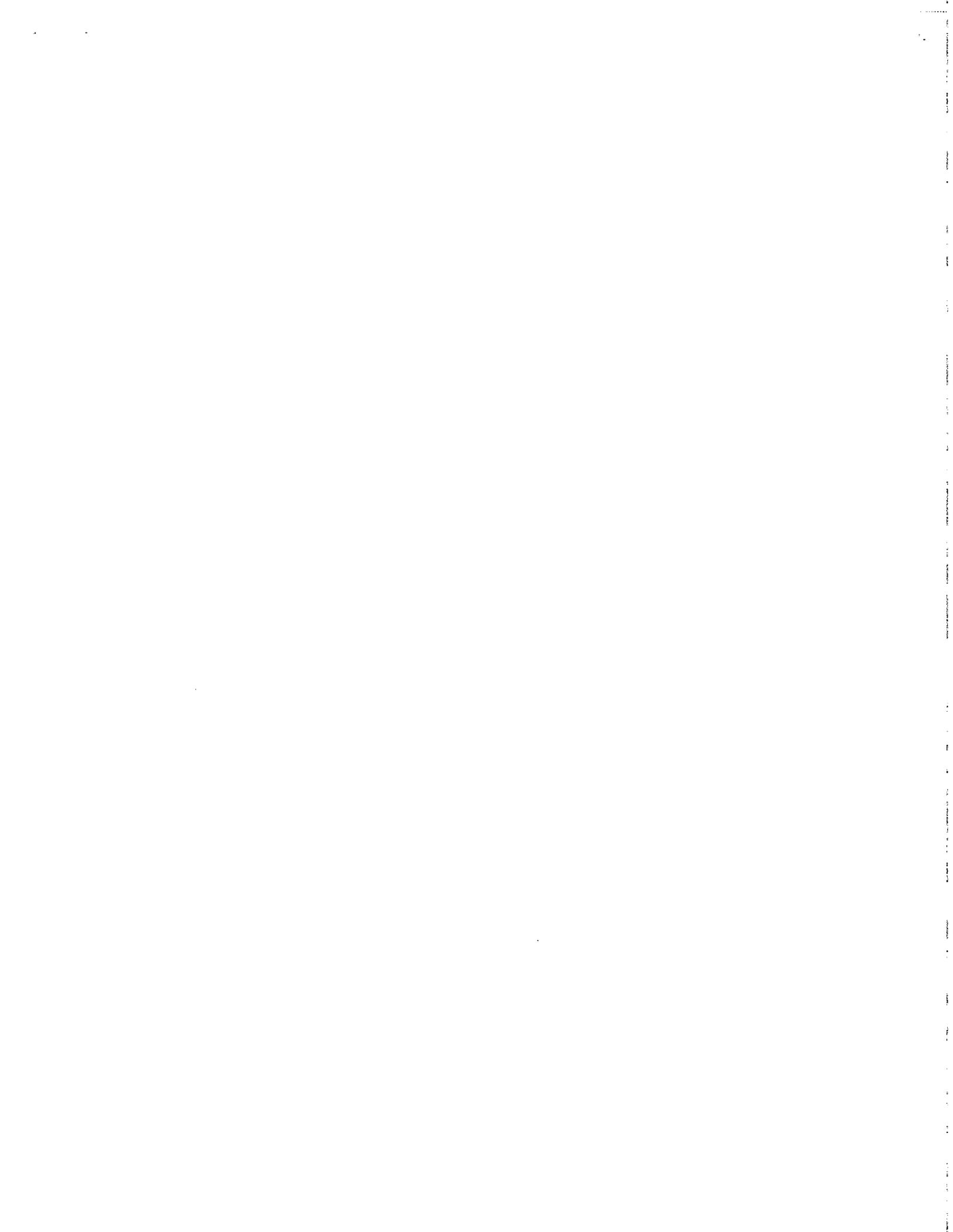
SOCIAL SECURITY

GAO's Analysis of the  
Notch Issue

Statement of Joseph F. Delfico, Director,  
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Dear Mr. Chairman and Members of the Commission:

Thank you for the opportunity to appear before you today to discuss our analysis of the differences in benefits for retirees with similar work histories known as the Social Security "notch" issue.

We have been involved with this issue for over 8 years and have testified before congressional committees numerous times. Our involvement with the notch issue began in April 1986 when the Chairman of the House Ways and Means Committee asked us to conduct a thorough and independent study of the notch. After a lengthy study, we issued a report in March 1988 and testified at a major hearing on the report's findings that April. Subsequently, we testified before the Senate Finance Committee in 1989 and again before the Ways and Means Committee in 1992.<sup>1</sup>

Mr. Chairman, in my testimony today, I would like to briefly cover the critical matters we believe this Commission must deal with in addressing the notch issue in today's environment. In summary, based on our analysis, retirees in the notch group who claim an inequity are comparing themselves to a group of retirees that received benefits based on an overgenerous formula. If the Congress chooses to pursue legislation, it should consider a number of factors, particularly the cost of financing any legislation.

#### THE FACTS SUGGEST THE NOTCH GROUP IS TREATED FAIRLY

As is well known, the "notch" refers to differences in benefits resulting from the new social security benefit computation rules, enacted in 1977, which became effective on January 1, 1979. In general, individuals born in 1916 (who turned 62 during 1978) were covered by the old rules and received higher benefits than individuals with similar earnings histories who were born in 1917 (who turned 62 during 1979) and were covered under the new rules.

The 1977 changes to the benefit rules were made necessary by a flaw in the benefit formula that arose after the Congress instituted automatic indexing in 1972. The inflation adjustment procedure had the effect of overindexing the benefits of future retirees, resulting in higher benefits awards than ever were intended by the Congress or earned by the worker. New benefit rules were put in place for those born in 1917 and later and

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<sup>1</sup>For a complete list of our work on the notch issue, see Related GAO Products.

transition rules applied to retirees born 1917 to 1921, who have become known as the notch group.

Concerning how the notch occurred, how it is defined, and whether it constitutes an inequity, I believe that our analysis has established the basic facts. While there has been criticism of the way the 1977 Social Security Act Amendments instituted the new benefit formula, the notch group generally fares better than most retirees coming before and after them. In fact, many in the notch group are among those who will receive the highest relative benefit levels in the history of the Social Security program. Fundamentally, the notch group is comparing itself to a group that got an unintended windfall from the system as a result of a flawed benefit formula.

Despite a significant effort to analyze and study the public record on the notch, the issue remains. Since the issue emerged in the late 1970s, many bills have been introduced in the Congress with significant numbers of cosponsors. Nevertheless, notch legislation has not been enacted.

#### FACTORS TO CONSIDER BEFORE TAKING LEGISLATIVE ACTION

Our view is that legislation requires very careful scrutiny. If a legislative remedy is pursued, what must be considered are the potential costs, the effect on the Social Security system as a whole, and whether providing additional benefits to the notch group will truly resolve the problem or instead create a set of new ones.

#### Notch Legislation Is Costly

Clearly, the proposed notch remedies will be costly. The Social Security Administration (SSA) projects that current notch legislation (H.R. 1883 and S. 173) will cost about \$42 billion over 10 years. While much attention is paid to the buildup of large trust fund reserves as a result of the legislation enacted in 1983, the Old Age and Survivors' Insurance (OASI) reserves have only recently reached adequate contingency levels. The system probably would not be at adequate contingency levels now if notch legislation had been enacted at an earlier date.

#### There Are Ramifications for the System's Finances

The Social Security system's financing picture is not as rosy as it was during the late 1980s. The projections of trust fund reserves are now lower than the projections of a few years ago, and the estimated exhaustion date of these reserves is sooner. In addition, other problems have arisen. The Disability Insurance (DI) program is facing higher costs because of rising caseloads. The disability claims process is being re-engineered, but the impact of this change on future costs is unclear. The anticipated exhaustion of the DI fund has resulted in pending congressional

action to reallocate a portion of the OASI payroll tax rate to DI. Furthermore, the potential financing problems in Medicare are a continuing cause for concern. Given these immediate financial concerns, further diminishing the OASI trust fund reserves to finance a notch remedy is not a prudent course of action in our view.

#### Increased Costs to Today's Workers May Erode Public Confidence

Any new spending resulting from notch legislation would be subject to the "firewall" provisions of the 1990 Budget Enforcement Act. Financing additional benefits would require new revenue sources, such as an increase in payroll taxes, or offsetting spending reductions. A payroll tax could be unfair to current workers already paying more into Social Security than current pay-as-you-go costs. Reports that today's workers, particularly the young, doubt they will receive anything from Social Security are a cause for concern. Awarding more benefits to the notch group may have the effect of further eroding confidence in the system.

Reducing expenditures is one area, perhaps, where a "fairer" solution could be found if it took the form of reducing the benefits of those who received an unintended windfall as a result of the flawed formula.<sup>2</sup> However, this alternative was considered by the Congress but not taken in 1977.

#### Administrative Implementation Causes Concern

In addition to the broad considerations just outlined, we are concerned about SSA's ability to meet the challenges associated with implementing a notch remedy. In our 1988 report, we raised the operational concern that is as important today as it was then. The administrative complexity of implementing notch legislation will place additional burdens on an agency facing major change. SSA will have to perform recomputations for millions of beneficiaries and because SSA's systems cannot be reprogrammed easily, major operational changes will have to be made and costs incurred. The uncertainty of SSA's staffing and organizational structure as it becomes an independent agency, the re-engineering of the disability program, and the expansion of the Personal Benefits Statement project all need to be considered if notch legislation is debated.

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<sup>2</sup>This remedy could also reduce benefits for some in the notch group as well as those born between 1910 and 1916 who received benefits under the pre-1977 benefit formula.

That concludes my statement Mr. Chairman. I'd be happy to answer any questions that you or the Commission members might have.

For more information on this testimony, please call Joseph Delfico, Director, Income Security Issues, at (202) 512-7215. Key contributors included Donald Snyder, Assistant Director; Kenneth Bombara and Michael Packard, Senior Economists.

RELATED GAO PRODUCTS

Comments on the Social Security Notch Issue (GAO/T-HRD-92-46, July 23, 1992).

The Social Security Notch Issue (GAO/T-HRD-89-2, Jan. 23, 1989).

The Social Security Notch Issue (GAO/T-HRD-88-15, Apr. 22, 1988).

The Social Security Notch Issue (GAO/T-HRD-88-14, Apr. 14, 1988).

Social Security: The Notch Issue (GAO/HRD-88-62, Mar. 24, 1988).

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