Policy Issues in Social Security

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THE PERIOD immediately ahead promises to be one of wide public discussion of our social security program. President Johnson has indicated that he will propose major improvements in the program in time for action by the next session of Congress and has asked us to complete our studies of alternative possibilities with this legislative timetable in mind. As part of our study we will be consulting with various groups to make sure that we have taken into account the ideas and interests of those most affected and we will, of course, be examining all the major policy issues involved.

My primary intention here is to describe some of these policy issues. First, however, I would like to bring you up to date, in general terms, on where we stand today. What are the major characteristics of our present social security system and what is the level of its accomplishment? It seems desirable to have at least some general answers to these two questions before proceeding to the policy issues that lie ahead. In this discussion I will usually be following popular usage and using the term "social security" to mean primarily our national system of contributory social insurance—old-age or retirement insurance, survivor's insurance primarily for widows and orphans, long-term disability insurance, and health insurance for those aged 65 or over.

Social security is today a major institution in the economic and social life of the Nation—as much taken for granted by the generation that has grown up since the 1930's as free public education or a government-operated post office. Forgotten is the controversy surrounding the establishment of such a government activity, and although there are many differences of opinion concerning proposals for changing this or that part, the function itself is no longer under serious attack.

Seldom if ever has a new institution grown so fast and received such wide acceptance so quickly. It is worth while, I believe, to try to say why this has come about—to say why in so short a time there is such widespread backing for social security when the very idea was almost unknown in the United States at the time of the passage of the Social Security Act just 31 years ago.

To grow, and indeed, in the long run even to endure, an institution must meet fundamental human needs and must be in line with fundamental human motivations. Institutions can be modified and shaped, but they cannot be improvised; they must emerge from and conform to the experience of the human race. What then is this institution?

THE IDEA OF SOCIAL SECURITY

The idea of social security is so very simple that the wonder is why it came to have broad application such a long time after the basic concept had been invented and applied on a small scale in the protective funds of the medieval guilds and in the fourteenth and fifteenth century customary funds for those engaged in mining. For although 78 countries of the world now have broad social insurance systems, the widespread application of the method of social insurance as distinct from relief and public assistance has been almost entirely a development of the present century.

The idea is simply that while people work and are earning they contribute a part of their earnings to a fund, with contributions from the employer and now, in many countries, also from the government. When earnings stop because one is too old to work or too disabled to work or because the wage earner in the family dies or because there is no job to be had or there are extra expenses connected with illness, for example, then the accumulated funds from all contributors are used to make up for the loss of income or to meet, in part or in whole, the expenses incurred. In return for setting aside some of the money one has when one is earning, the system provides an assured income when one is not.

Social insurance, like all insurance, averages out among all who are covered the risk that is too

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much for any one individual to bear. The fact that the protection is the automatic accompaniment of a job makes practically universal protection assured. Eligibility for protection grows out of work that people do, with any savings they may accumulate on their own available over and above their social security benefits. It is thus based upon the traditional motivations of pay for work and rewards for saving.

The impact of social insurance in the lives of retired people, the disabled, and widows and orphans has been nothing short of revolutionary. But social insurance is anything but revolutionary in concept. It relies on the age-old tradition of self-help, and, like private pension plans and private insurance, is connected in people's minds with the responsible and prudent management of their own affairs.

It is the reliance of social insurance on this accepted tradition that accounts in large part for the speed with which this new institution has been incorporated into our way of life. Social insurance has brought about a sweeping social reform within the framework of an old tradition.

SOCIAL SECURITY TODAY

The popularity of the method has meant rapid growth. Just 16 years ago, in 1950, before the first of the recent series of social security improvements, only about 25 percent of the people aged 65 and over were protected under social security and very few had any other kind of retirement coverage. Today 85 percent are protected under social security, and, if you add the number protected under the civil-service retirement and railroad retirement systems, 90 percent of the present aged have pensions they can count on under programs of the Federal Government, based upon their work and contributions and paid without a test of need. If we look at those who became 65 last year, instead of at all the aged, 92 percent were eligible for social security benefits and about 97 percent were protected under one of these three Federal retirement systems. The problem of universal protection, then, is just about solved—an amazing accomplishment for a 15-year period.

About 80 million earners contributed to social security last year, and people in one of the latest groups to be brought in—self-employed doctors—are filing their first social security returns with their income tax this week. Tips were also covered for the first time by the 1965 amendments. For the very last group left out—the Federal employees—the President has recommended a transfer of credit plan that, in effect, guarantees Federal civilian employees social security or equivalent protection, regardless of movement back and forth into private industry. Today better than 9 out of every 10 mothers and children are protected against the risk of loss of income from the death of the family breadwinner. The survivorship protection of the program alone had a face value of about $700 billion as of the first of the year.

Some 21 million men, women, and children—1 out of every 9 persons in the country—are receiving monthly social security benefits. The beneficiaries include about 14 million retired workers and dependents of retired workers, nearly 2 million disabled workers and dependents of such workers, and about 5 million survivors of deceased workers. Social security cash benefit payments will amount to $20 billion this year.

Virtually all of the 19 million people who will be aged 65 and over on July 1, 1966, when the new health insurance plan enacted last year goes into effect, will be eligible for basic hospital benefits. As of mid-April, 88 percent have elected to participate in the voluntary supplementary medical insurance plan. About 1 million, or 5 percent of those eligible, have notified us of their decision not to elect the medical insurance protection. With the extension of the deadline we expect that some of this 1 million will change their minds and applications will come in by May 31 from some of the 1.3 million or 7 percent not yet heard from.

As social insurance has expanded over the years, it has taken over much of the load that had been carried by aid to families dependent with children and old-age assistance. The number of orphans under age 18 getting survivor benefits under social security increased from 18,000 in June 1940 to about 1.8 million at the beginning of 1966. In the same period the number of orphans getting payments under aid to families with dependent children dropped from 347,000 to an estimated 165,000. Actually, the program of aid to families with dependent children as a whole has grown because its scope has been broadened and the population served has grown, but today only a small proportion of orphans are on the assistance rolls. Since 1950 the percentage of the older population getting old-age assistance has been cut about in half, dropping from 22 percent to 11 percent.

The insurance program does much more, though, than reduce the need for assistance. Social insurance in this country has taken a form that has made it not just a program for low-income people but rather a universal retirement system supplemented with disability and survivorship protection and now health insurance for persons aged 65 or over. Those covered are not only the low-wage earners, who in Europe were the group for whom social insurance was first designed, but also farm owners, self-employed business men, professional people, supervisory and executive staff, and skilled and high-paid labor. As well as being designed to prevent poverty, then, the system has the same objectives as any retirement system. And like any retirement system, it is aimed at helping people to live in retirement at levels above a minimum subsistence. It does this partly by paying a variable benefit based on past earnings, and partly because the program is designed so that people who save on their own can add their savings to their social security benefits.

Actually, social security is the only retirement system for over 80 percent of the beneficiaries, and the combination of social security and a supplementary pension plan is the retirement system for the rest. Even for the latter, though, it is important to remember that social security usually accounts for more than half of the total pension. Over the next 25 years this figure might change to 72–75 percent and 25–30 percent.

It is highly desirable, I believe, that social security continue its role as a retirement system for earners at all income levels and not be transformed into one designed exclusively for poor people. Both types of programs are needed, of course. But the continued reliance on social security as the plan supplying the major part of retirement income has many advantages, particularly in terms of assuring the security of the pension and of facilitating the mobility of labor, over counting on private pensions to play a larger and larger role.

Several analysts, ignoring the retirement system functions of social security, have recently evaluated its role as if its entire purpose were to keep people out of poverty. This is an important objective of social security, but it is not the whole story. About three-fourths of the aged who get social security benefits either are in the poverty group, strictly defined, or would be if it were not for social security. But payments to the other fourth, most of whom have low incomes even though above the poverty level, are not the result of clumsy design. Judged as the retirement system it is, social security properly contributes to the income security of higher paid earners and to those who can be expected to have savings. It is true that public assistance or a negative income tax, or any system of paying money to people who demonstrate they don't have enough, by definition would do a better job of getting money to only the very poor, but why would we want to limit our economic security objectives to such a goal? A "minimum income for all" might have been a stirring objective when it was proposed by Sidney and Beatrice Webb about 1910, but we can do much better than that in the United States in 1966.

THE LEVEL OF BENEFITS

This, then, is the nature of our social security system today. What should be done to improve it? The President, when signing the bill extending the deadline for signing up for Medicare, emphasized the most pressing need when he spoke about making social security benefits more adequate. Social security benefit amounts are virtually the sole reliance of half the beneficiaries and the major reliance of just about all. The adequacy of these benefits, therefore, is the key fact in determining how well people will be able to get along in retirement, and the same is true for widows and orphans and the disabled. Yet improvements in cash benefits in recent years have not quite kept the benefits up to date in terms of purchasing power. The 7-percent increase last year fell slightly short of restoring the 1958 purchasing power of the benefits, and the 1958 increase of about 7 percent also fell slightly short of restoring the 1954 level. This means that those on the rolls throughout this period have not shared in the rising level of living of the rest of us, and, of course, the benefits were low to begin with, even in terms of the 1954 standard of living.

It is true that for most of those who have not yet retired and who will be working under the program for a longer period of time, the recent amendments will result in a considerable increase in benefit levels. Earnings up to $6,600, instead of $4,800, are now counted for benefit purposes, and as wages rise so will future benefits. Ultimately the maximum benefit for a worker will be $168 instead of the $135.90 maximum today. For a couple, the maximum will be $252 a month instead of the present maximum of $203.90.

For the man who regularly earns average wages—about $5,600 a year—the benefit in the future for himself and his wife will be about $225 a month or about 50 percent of earnings, and for the one who earns regularly at the level of the Federal minimum wage—amounting to about $2,600 a year—the benefit for the couple will be about $140 a month or about two-thirds of previous earnings.

These amounts need to be increased. It cannot be assumed that retired workers who earned only minimum wages have significant assets or income from other sources; the benefit for such retired workers is usually all they have to live on. For the worker who is under the social security program full time and who has earned only minimum or near minimum wages, our objective should certainly be to pay amounts above the minimum standards we have been using to measure the poverty line. In our studies we have set these minimum standards now at about $155 a month for elderly couples or about 10 percent more than the benefits payable to the steady worker and his wife earning the Federal minimum wage. Single people are somewhat worse off in relation to the poverty standard—as, also, are those who do not work regularly under the system.

Thus the first order of priority is an increase in benefit levels, and I would say that increase is needed throughout the whole range of covered earnings and not just for those earning minimum amounts. A *general* benefit increase is necessary if the program is to continue in its role as a useful retirement system for workers with average and above-average earnings as well as those at the minimum.

There are other policy issues, too, in the area of benefit amount. We are concerned about the low amounts of some of the actuarially reduced benefits payable under present law to those who claim benefits before 65. More than half the men awarded retirement benefits in 1965 are getting reduced benefits because they came on the rolls before age 65, and their benefits are, on the average, much lower than the benefit amounts payable to men who came on the rolls at age 65 or after. For the former, the average is about $78 a month, compared with about $107 a month for the latter.

AUTOMATIC ADJUSTMENT OF BENEFITS

In addition to the need for improving the adequacy of social security benefits as initially awarded, there is also the question of keeping the benefits up to date once they have been determined. Many people are on the benefit rolls for 15 or 20 years, or even longer, after entitlement. Both the civil-service retirement system and the military retirement system now include provisions to automatically adjust benefits to increases in the cost of living. Certainly such a provision should also be considered for the social security system.

Automatic adjustment of social security benefits to changes in price levels could be provided for without increases in the contribution rates that underlie the financing of the system. As wages rise, additional contribution income becomes available to the system and, because wage levels rise faster than price levels, the additional income would be more than sufficient to pay for adjustment of benefits to changes in price levels—provided that, from time to time, the contribution and benefit base is increased as earnings levels rise.

A more adequate, though more costly, adjustment would be one to keep benefit amounts in line with earnings levels. Such an adjustment would result in the automatic sharing by retired people in the increasing productivity of the American economy and the consequent rise in the community standard of living. Several European countries have provisions in their social insurance systems that update the earnings of the beneficiary at the time he first comes on the benefit rolls to reflect changes in wages over his working lifetime. These provisions maintain the differentials between higher- and lower-paid workers but adjust the average of earnings on which the individual's benefit is based to take account of increases in wage levels generally. Thus, the benefits when first awarded reflect the beneficiary's relative position in the economy in terms of current standards of living. Subsequent benefit adjustments are then related to changes in wage levels after his retirement.

Such an automatic adjustment to wages would, of course, require more financing than adjustment to prices. Another disadvantage of a system that automatically adjusts benefits to wages is that the benefit structure may tend to become rigidly straitjacketed in the original form in which it was developed. Under a plan for automatically adjusting benefits to earnings levels, all of the gain to the system from the increases in earnings would necessarily be distributed over the beneficiary population in strict proportion to the benefits already payable. Otherwise, they might have been distributed in a different manner—for instance, to increase benefits payable to people who come on the rolls before age 65 relatively more than those payable to people who come on after that age.

One possible in-between position is to relate benefits to recent wages before retirement, as the civil-service retirement system tends to do by relating benefits to the average salary over the 5 highest years, and then keep up to date with prices for those on the benefit rolls.

ADJUSTING THE CONTRIBUTION AND BENEFIT BASE

In conjunction with an increase in benefit levels, an increase in the contribution and benefit base—the maximum amount of annual earnings that is taxed and counted for benefit purposes—should also be considered. Congress has made periodic adjustments in the contribution and benefit base sufficient to keep it approximately in line with the $3,600 figure adopted in 1950, but the maximum has not been adjusted to anywhere near the degree needed to keep up with the rise in earnings since the beginning of the program. If the base were to be restored to a figure comparable to the $3,000 figure provided in 1935, it would have to be raised to about $15,000.

If the protection provided by the social security program is not to deteriorate, this contribution and benefit base must rise as earnings levels rise. To the extent that the base does not keep up with increased earnings, a larger and larger proportion of workers have earnings above the base, and a smaller and smaller proportion of workers get benefits related to their full earnings. Eventually the program would pay to almost everyone a benefit unrelated to his previous earnings because almost everyone would have had earnings above the limit set by the base. Keeping this base up to date is the factor that determines how much of the job of providing retirement security is to be done by social security and how much of the job is to be either left undone or left only partially done by private pension plans.

Failure to raise the base as earnings levels rise also limits seriously the ability of the program to respond to new and emerging needs because it weakens the financing of the program: a smaller and smaller proportion of the Nation's payrolls is subject to social security contributions. The effect of this decrease in the proportion of total earnings that is taxable is that the tax rates have to be higher to finance a given rate of benefits, and, since the tax is imposed as a single percentage rate, a greater part of the program's cost falls on the lower-paid workers—those earning less than the limit set by the base—than if the base were raised. The weighted benefit formula and a percentage contribution rate makes the financing of the system progressive over the long run—provided that the contribution and benefit base is relatively high. Flat-rate benefits and flat contributions, as in the basic British system, for example, add up to very regressive financing and also to a very weak system of financing. This is because flat contribution amounts have to be geared to what the person with the lowest income can pay and therefore have to be low. I might add that the British have recently instituted a second system more like ours, and that Canada, which also has a basic system paying flat benefits, has now added a wage-related system like ours.

Because of the importance of keeping the contribution and benefit base up to date, some thought needs to be given to whether the base should automatically rise as wages rise. Such a change would more than finance tying benefits to the cost of living and would also tend to keep the benefits of workers with average and above-average earnings up to date by including all or almost all of their wages in the benefit computation.

GENERAL REVENUE CONTRIBUTION

A general benefit increase any greater than the 7-percent increase of last year could not be financed by an increase in the contribution and benefit base alone.

For this purpose it would be necessary, in addition, to raise the contribution rates scheduled in the law or to introduce a government contribution. Various possibilities will be considered.

In considering a government contribution it should be borne in mind that in order to make the social security program quickly effective in its early years, Congress decided to provide full-rate benefits to people who were already old when their work was first covered under the program, even though only a small percentage of the actual cost of the benefits payable to these people was met by the contributions they and their employers paid. This was sound public policy, necessary to help prevent widespread want and destitution and to contribute to the social and economic security of the Nation as a whole. But it has meant that the excess of the value of benefits over the value of the contributions in the early years of operation will be financed from future contributions. As a result, future generations of covered workers will get protection that is worth less than the combined employer-employee contributions with respect to their earnings, since some part of these combined contributions will necessarily go to meet part of the cost of paying full benefits in the early years. It is true that future generations of workers will get protection that is worth at least as much as the value of *their own* contributions. Nevertheless, there is some merit in meeting the cost of paying full benefits in the early years through a contribution from the general revenues so that all of the employer and employee contributions with respect to workers now young can be used to pay their benefits when they retire. Since the employer contribution in part, at least, is shifted to workers in the form of lower wages, it might be more equitable to finance from general taxation part or all of the so-called "accrued liability" resulting from payment of full benefits to the first generation of covered workers and so introduce another element of progressivity into the financing of the program.

The idea that the accrued liability costs could be met from general revenues is not a new one. It is, for example, part of the reasoning behind the government contribution in the British system and was mentioned by the Committee on Economic Security — the Committee that in 1934 recommended the establishment of the original program for the United States. Just recently in the United States the Cabinet Committee Report on Federal Staff Retirement Systems, which the President endorsed and transmitted to the Congress on March 7, used similar reasoning concerning the civil-service retirement system. They recommended that the financing of the civil-service retirement system should be based on the theory that the contributions of employees and of the Federal agencies, as employers, should fully meet the system's normal cost—that is, the combined employee-agency contributions should be at a rate that would have to be paid over the working lifetime of new entrants to the system to pay for the benefits provided under current law, and the Government should finance the accrued liability by direct appropriations. The "normal cost" of social security is about two-thirds of the total costs over the long run so that, if general revenues were to take care of the entire one-third attributed to accrued liability, about one-half again as much money as at present would be available for program improvements. Another way of looking at such a government contribution is that it is in lieu of the interest that would have been available from full reserve financing.

Contribution rate increases are also, of course, a possibility. These would be additions to the present employee contribution schedule, which for cash benefits rises from 3.85 percent this year to 4.85 percent in 1973, with the employer paying a like amount. Contribution rates for hospital insurance will be an additional ½ of 1 percent next year and will rise to $\frac{8}{10}$ of 1 percent in 1987 and later.

OTHER CHANGES

There are a number of other changes that might be considered, particularly changes designed to close gaps in the social security protection of workers and their families against loss of earnings due to disability. We will need to study also whether the Medicare program should be broadened to include additional social security beneficiaries—particularly disabled workers, as recommended by the 1965 Advisory Council on Social Security.

I suppose it is not right to conclude a discussion of policy issues in social security without mentioning the "test of retirement," which always seems to be the number one candidate for change or abolition. The program operates on the theory that benefits are paid to make up for a loss of earned income—that is, that the risk being insured against is *retirement* after a specified age, not merely the attainment of that age. It is a retirement program, not a pure annuity program. If benefits were to be paid to all people upon the attainment of age 65 regardless of whether they continued to work or not, the program would pay out about $2 billion a year more in benefits, and it would require a combined employer-employee contribution rate of about $\frac{8}{10}$ of 1 percent more than now scheduled. It does not seem to most of us that this would be a particularly good way to use the funds of the system when one considers that the $2 billion would go mostly to people who would continue to work at regular employment just as they had at age 50 or 55. Nevertheless, this provision will certainly come in for study once again.

CONCLUSION

A quarter of a century ago. Lord Beveridge, in his famous report on the social insurances, put forth the proposition that the abolition of want "was easily within the economic resources of the community." "Want," he said, "is a needless *scandal* due to not taking the trouble to prevent it." From the standpoint of *economic capacity* this statement was indisputable when it was made. And its truth is, of course, even more obvious in America today than in England in 1942.

Our situation in this regard is unique in the history of the world. Poverty in the past has been basically the result of the fact that there was not enough to go around. This is still the situation in most of Africa, Asia, and South America. The great majority of people living in those areas are poor and will remain so until there is a major increase in the per capita production of goods and services. In the underdeveloped countries, in which two-thirds of the world's population lives, no welfare or social security program could overcome the hard fact that there just isn't enough to go around. By contrast, today it can be taken as a fact that the abolition of want in the *United States* is no longer a problem of economic capacity but of organization for an objective.

Although the problem of poverty is complex, one part of the problem, and fortunately a rather major part, can be cured relatively easily in our prosperous country and without major changes in our system of economic values. We know how to do it—the institutions are at hand—what we need to do is to build on them.

Economic insecurity in a money economy arises in considerable part when earnings stop because of unemployment, retirement in old age, death of the family breadwinner, or disability, either short-term or long-term. No matter how high the level of production, poverty will persist unless there are institutional arrangements for making sure that all have the continuing right to share in consumption when these risks occur. To provide such continuing income is the principal role of social insurance.

Thus we have at hand a widely applicable and widely acceptable instrument. Its objective is not solely the abolition of poverty, but in its operation it does prevent poverty. *It can be used much more effectively for this purpose.* Perhaps one-fourth to one-third of all the poverty that exists in the United States could be prevented by the improvement and broader application of the social insurance principle, both in the Federal program I have been talking about and in our Federal-State program of unemployment insurance. Some part of the problem of poverty is best solved by expansion in job opportunities and preparing workers to fit those opportunities. On the other hand, a major part of the problem can best be met by an expansion of insurance against the loss of job income so that retired people, the disabled, widows and orphans, and those between jobs can have an assured and adequate income when not working.

Having had the vision and seen the possibility of a country without want, we cannot fail to devote our best efforts towards attaining that vision. A hundred and eighty years ago we undertook to "secure the blessings of liberty to ourselves and our posterity." A major challenge to us now is, while preserving that liberty, to secure the blessings of abundance to all of our people.