THE EMERGENCE, GROWTH, AND REDIRECTION OF SOCIAL SECURITY: AN INTERPRETIVE HISTORY FROM A PUBLIC CHOICE PERSPECTIVE

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INTRODUCTION

> What is clear from the proliferation of bureaucracy is that government programs grow in ways that are often unforeseen and with results that are often unpredictable. The federal agency that assists more Americans than any other--the Social Security Administration--is a perfect case in point. Founded during the Depression, the almost universally praised institution now sends a monthly check (average amount: $200) to one in every seven Americans.[1]

Regardless of the measure employed, Social Security has experienced phenomenal growth in the forty-two years since its enactment in 1935. When enacted, Social Security encompassed only one funded, federal insurance program--old-age insurance--with only one beneficiary category--the retired worker. By 1976, the program had grown to encompass four separate social insurance programs--old-age, survivors', disability, and hospital insurance--distributing monthly benefits on a pay-as-you-go basis to more than twenty different beneficiary categories with diverse age and eligibility requirements. Between 1940-1976, the number of beneficiaries of Social Security had grown from 22,000 receiving an average real cash benefit of $68 to 33 million receiving

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[1]"Big Government," Newsweek, December 15, 1975, p. 37.

an average real cash benefit of $190.[1] To partially finance this expansion, over the same period of time, the Social Security tax rose from 2 percent paid by 35.3 million covered workers to 11.7 percent paid by more than 100 million covered workers.[2]

Social Security is currently (1977) the largest domestic government program in the United States, spending more than $91.7 billion a year, with the largest public information service in the world.[3] In spite of a 225 percent increase in the real maximum tax payment since 1960, as of January, 1977, the system had accrued an actuarial deficit of $4.3 trillion.[4]

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[1] U.S. Department of Health, Education, and Welfare, Social Security Administration, Social Security Bulletin, Vol. XL, No. 5 (Washington, D.C.: Government Printing Office), p. 41. Unless otherwise noted, all real figures are calculated on the basis of 1975 dollars; see Department of Commerce, United States Statistical Abstract (Washington, D.C.: Government Printing Office, 1976), Table 122.

[2] Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 65.

[3] This figure includes expenditures on benefit payments and administrative costs under the insurance titles of OASDHI. See Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, pp. 37-39. Regarding the size of Social Security's public information staff, see Warren Shore, Social Security: The Fraud in Your Future (New York: MacMillan Publishing Co., Inc., 1975), p. 29.

[4] A $4.3 trillion deficit means that if $4.3 trillion were placed in the trust funds today and kept invested at the market rate of interest, the accumulating fund plus the revenues from scheduled payroll taxes would be just sufficient to pay off scheduled benefits for the next seventy-five years. Alternatively, $4.3 trillion is the present value of the excess of planned expenditures over planned revenues during the next seventy-five years. See A. Haeworth Robertson, "OASDI: Fiscal Basis and Long-Run Cost Projections," Social Security Bulletin, Vol. XL, No. 1, p. 25.

Purpose and Scope

In an overall sense, the purpose of this study is to analyze and interpret, from a public choice perspective, the emergence, redirection, and growth of Social Security. To date, there has been no attempt to explain the evolution of this program within an integrated framework of non-market institutional change which incorporates both the recent literature on the economics of bureaucracy with the more traditional literature on the demand for public sector activity. As such, this study represents an endeavor to recast and review the historical-institutional evolution of Social Security, taking account explicitly of a theory of bureaucracy, so that the current and future growth as well as the proliferation of the program need not be viewed as entirely"unforeseen and with results that are often unpredictable." Alternatively, this economic, political, and institutional case-study of Social Security can be viewed as a preliminary test of the relative explanatory power of pure demand- and pure supply-side models of public sector growth.

In a broader sense, the importance of this study extends beyond the growth of a single program since it should provide insight into the more general question of government growth. A better understanding of the forces leading to the pronounced centralization of governmental activities, the dramatic increase in the public share of the economy, and the acceleration in the growth of non-market controls during this century is clearly the first step in designing institutional reforms that might lead to a reversal of these trends.[1]

Alternative Paradigms for Explaining Non-Market Institutional Change

A general framework for examining non-market institutional change or, more specifically, the emergence and development of governmental institutions, requires an integration of two distinct public choice paradigms: the demand-side and supply-side approaches.[2] The demand- and supply-side approaches constitute two alternative and necessarily conflicting views of the determination of public sector outcomes. In one case, the government is an entity which responds

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[1] For several informative sources on the growth of government and non-market controls in the United States, see Thomas E. Borcherding, "One Hundred Years of Public Spending, 1870-1970," in Budgets and Bureaucrats: The Sources of Government Growth, ed. Thomas E. Borcherding (Durham, N.C.: Duke University Press, 1977), pp. 19-44; Roger A. Freeman, The Growth of American Government: A Morphology of the Welfare State (Stanford: Hoover Institution Press, 1975); Solomon Fabricant and Robert E. Lipsey, The Trend of Government Activity in the United States Since 1900 (New York: National Bureau of Economic Research, Inc., 1952); and Jonathan R. T. Hughes, The Governmental Habit: Economic Controls from Colonial Times to the Present (New York: Basic Books, Inc., 1977). For a study of the growth of government internationally, see Richard E. Wagner and Warren E. Weber, "Wagner's Law, Fiscal Institutions, and the Growth of Government," National Tax Journal, XXX, 1 (March, 1977):59-68.

[2] For a general discussion of these two views and the need for integration, see James M. Buchanan, "Why Does Government Grow?" in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 3-18; and "Public Finance and Public Choice," National Tax Journal, XXVIII (December, 1975):383-394. For an empirical attempt to separate out that proportion of government growth that can be attributed to either supply or demand side aspects of public sector activity, see Thomas E. Borcherding, "The Sources of Growth of Public Expenditures in the United States: 1902-1970," in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 45-70.

passively and automatically to registered voter demands; in the other, the government is comprised of an array of self-interested politicians and bureaucrats who, in the presence of costly and imperfect information, participate directly in the collective choice process and, moreover, have a perceptible impact on public sector outcomes.

The Demand-Side Approach and Implications for Social Security

The demand-side approach, in its pure form, is a democratic model in which growth of the public sector is explained as the outcome of changes in demands by resident-voters as transmitted and aggregated through the voting process. Since markets may fail to emerge for the efficient exchange of public goods, non-market institutions are viewed as emerging from agreement among the members of society to exhaust the efficiency gains of collective action.[1] Whether it be the result of constraints on individual behavior associated with a constitutional delineation of rights of the collectivity, or the existence of fierce political competition, or the assumed nature of "public servants," non-market institutions are assumed to be staffed by a body of bureaucratic and political representatives who

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[1] See James M. Buchanan, The Demand and Supply of Public Goods (Chicago: Rand McNally and Co., 1968), and The Limits to Liberty: Between Anarchy and Leviathan (Chicago: The University of Chicago Press, 1974), pp. 17-52; James M. Buchanan and Gordon Tullock, The Calculus of Consent: The Logical Foundations of Constitutional Democracy (Ann Arbor: University of Michigan Press, 1962); and Lance E. Davis and Douglass C. North, Institutional Change and American Economic Growth (Cambridge: Cambridge University Press, 1971).

automatically respond to broad-based citizen demands in the process of securing for their employers efficiency gains.[1]

The implication of this approach is that the observed proliferation of government institutions and the concomitant growth of government are traceable directly to voters' demands for more public goods and services, and their acquiescence in paying additional taxes. In a very real sense, the particular institutions and conditions of public supply are only important to the extent they affect the relative real costs and benefits of government activity.[2]

According to this view of government activity, there are two frequently cited explanations for the emergence of a compulsory, federal old-age insurance program in 1935. Each explanation is based upon the premise that there were marked changes in underlying economic conditions as they affected the material status of the elderly. One

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[1]For a statement of the view that politicians and bureaucrats are perfectly constrained by political competition, see George Stigler "Economic Competition and Political Competition," Public Choice, XIII (Fall, 1972):91-106.

[2]For a selection of pure demand-side papers which are institutionless except for the inclusion of a collective decision process, see Thomas E. Borcherding and Robert T. Deacon, "The Demand for the Services of Non-Federal Governments," American Economic Review, LXII (December, 1972):891-901; Theodore C. Bergstrom and Robert P. Goodman, "Private Demands for Public Goods," American Economic Review, LXIII (June, 1973): 280-296; William J. Baumol, "Macroeconomics of Unbalanced Growth: The Anatomy of the Urban Crisis," American Economic Review, LVII (May, 1967):415-426; and Winston C. Bush and Robert J. Mackay, "Private Versus Public Sector Growth: A Collective Choice Approach," in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 188-210; the former two being empirical studies of the demand for various public services, the latter two being theoretical models of the growth of government.

explanation is that the existence and increasing incidence of poverty among the elderly, concomitant with the process of industrialization and urbanization, generated demands for an institutional means of enforcing upon the individual the obligation to insure against the financial hazards of old-age. Whether it represented a decision on the part of the members of society to enforce this obligation upon themselves, or a decision on the part of a broad-based majority to enforce this obligation on other less long-sighted persons, a compulsory system of old-age insurance was a direct means of offsetting the disincentive effects created by public welfare institutions.[1] In so doing, a system of Social Security would help mitigate, in the long run, the rising incidence of public welfare costs.

An alternative demand-side view of the emergence of Social Security is that the onset of the Great Depression in 1929 made voters painfully aware of the fallibility of private savings and insurance institutions. Given the plight of the elderly, the need became

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[1]For an alternative view from a constitutional perspective, see James M. Buchanan and Gordon Tullock, The Calculus of Consent, pp. 189-199.

An extreme myopia view of the function of Social Security was expressed by Paul Webb, regional commissioner for the Social Security Administration, when he said ". . . critics make the unlikely assumption that we humans, if we did not pay into Social Security, would wisely save our money or buy a private insurance policy of high value." Cited by Warren Shore in Social Security: The Fraud in Your Future, p. 97. See also, Paul A. Samuelson, "Optimum Social Security in a Life-Cycle Growth Model," International Economic Review, XVI (October, 1975):539-544.

apparent to supersede the normal market process in making old-age insurance available on a broad-scale and safe basis.[1]

A closer look at each of these explanations, however, reveals a number of unanswered questions. If we accept the first, myopia argument, how then can we explain the step from the requirement of compulsory purchase of insurance to compulsory purchase from a single producer? Alternatively, if we accept the second, market failure argument, how then can we explain the step from federal production to compulsory purchase and, moreover, compulsory purchase from the federal producer?

Even if we accept the view that Social Security was an institutional means of resolving both of these problems, how can we explain the rapid growth in the program?[2] In 1950, real annual expenditures

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[1]For example, Abraham Epstein, an early social insurance advocate, cited the failure of private insurance markets as one of several key reasons for enacting compulsory old-age insurance in Insecurity--A Challenge to America: A Study of Social Insurance in the United States and Abroad (New York: Harrison Smith and Robert Haas, 1933), pp. 116-140.

Two other rationalizations for Social Security are the potential gains from a pay-as-you-go system, and the social gains from an income redistributive program. They are not discussed here because the former was not employed in 1935, and the latter is not a reason for creating a compulsory "insurance" program.

[2]Even taking into account such factors as income, scheme of financing, political system, and proportion of elderly population, empirical studies of the determinants of Social Security expenditures cannot fully account for the variation among countries. The ability of pure demand-side models to explain the variation is subject to question, since age of the system invariably enters the equations significantly and positively. See Joseph A. Pechman, Henry Aaron, and Michael Taussig, Social Security: Perspectives for Reform (Washington, D.C.: The Brookings Institution, 1968), pp. 300-304; and Harold L. Wilensky,

were \$2.2 billion financed by a 3 percent payroll tax. In 1976, real expenditures had reached \$87.3 billion, while the tax rate had reached 11.7 percent.[1] Given that real personal income rose only 2 1/2-fold over this same period, can the 40-fold increase in real expenditures and 150 percent increase in real benefit levels be explained as simply as increasing proclivity to "save," or an increasing proclivity to care for the elderly, or an increasing preference for equality?[2] Is there, in fact, no "fiscal crisis" as voters have been fully conscious of implied changes in future tax rates necessary to finance the \$4.3 trillion actuarial deficit? Indeed, are pure demand-side models any longer relevant in explaining the evolution of a program in which 33 million Americans are direct beneficiaries of public funds?

These types of questions are particularly troublesome when one attempts to address them within the confines of a democratic, or pure demand-side model. In fact, however, this has been the means by which government activity has been historically viewed. In recognition of the difficulties of explaining observed changes in public

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The Welfare State and Equality: Structural and Ideological Roots of Public Expenditures (Berkeley, Cal.: University of California Press, 1975), pp. 135-39.

[1]Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, pp. 37-39.

[2]For personal income data, see Ibid., p. 65. For information on real benefit increases, see Reports of the Quadrennial Advisory Council on Social Security, House Document No. 94-75, 94th Cong., 1st Sess. (Washington, D.C.: Government Printing Office, March 10, 1975), Table A.

institutions as lagged responses to changes in broad-based citizen demands, less ideal but nonetheless demand-side models were developed to explain the importance of rational abstention from voting and special interest groups on collective outcomes.[1] Only recently has attention turned to the impact of bureaucracy.

The Supply-Side Approach and Implications for Social Security

The supply-side approach to the collective choice process is more appropriately considered a non-democratic approach which incorporates explicitly a theory of bureaucracy.[2] The passive or perfectly constrained public employees characteristic of pure demand-side models are replaced by an array of self-interested bureaucrats who not only participate actively in the collective choice process but also may be

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[1] For an early discussion of rational abstention from voting, see Anthony Downs, An Economic Theory of Democracy (New York: Harper and Row, 1957), pp. 36-50. For demand-side models of government growth in which special interest groups are recognized to play important roles, see, in particular, Lance Davis and Douglass North, Institutional Change and American Economic Growth; James Buchanan and Gordon Tullock, The Calculus of Consent, pp. 284-295; and Larry L. Orr, "Income Transfers as a Public Good: An Application to AFDC," American Economic Review, LXVI (June, 1976):359-371.

[2] Two of the earliest works which applied economic theory to bureaucratic behavior and bureaucracy are Gordon Tullock, The Politics of Bureaucracy (Washington, D.C.: Public Affairs Press, 1965); and Anthony Downs, Inside Bureaucracy, Rand Corporation Research Study (Boston: Little, Brown, and Co., 1967).

expected to have a perceptible impact on public sector outcomes.[1] From this point of view, supply-side agents

> . . . are not helpless, passive pawns in the game of politics as it affects their lives; they are active, energetic persistent participants. The motives of their leaders and members to preserve the organization to which they belong are very strong. The techniques they can use are abundant, and their experience in using them is extensive.[2]

An essential feature of this approach is a recognition of the qualitatively different institutional environments within which the private firm and public bureau operate, with implications for the

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[1]For examples of works whose major thrust is an examination of the supply-side of the collective choice process and its impact on public sector outcomes, see amongst others, William A. Niskanen, Bureaucracy and Representative Government (Chicago: Aldine-Atherton, 1971); Ludwig von Mises, Bureaucracy (New Rochelle: Arlington House, 1969); Richard E. Wagner and Warren E. Weber, "Competition, Monopoly, and the Organization of Government in Metropolitan Areas," Journal of Law and Economics, XVIII (December, 1975):661-689; Richard E. Wagner, "Supply-Side Aspects of the Theory of Local Government: Owners, Managers and Take-Over Bids" (Mimeographed, Virginia Polytechnic Institute and State University, 1976); Arthur T. Denzau and Robert J. Mackay, "Benefit and Tax Share Discrimination by Monopoly Bureaus" (Mimeographed, Tulane University, 1976); Robert J. Staaf, "The Growth of the Educational Bureaucracy: Do Teachers Make a Difference?" in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 148-168; E. G. West, "The Political Economy of American Public School Legislation," Journal of Law and Economics, X (October, 1967):101-128; Jack A. Stockfisch, "Analysis of Bureaucratic Behavior: The Ill-Defined Production Process" (Working Paper, The Rand Corporation, Santa Monica, Cal., 1975); and Thomas Romer and Howard Rosenthal, "Political Resource Allocation, Controlled Agendas, and the Status Quo" (Mimeographed, Carnegie-Mellon University, 1976).

[2]Herbert Kaufman, Are Government Organizations Immortal? (Washington, D.C.: The Brookings Institute, 1976), p. 81.

bureau's production, price and output decisions.[1] By nature, the bureau is generally immunized from the efficiency generating forces of the market process. Not only is the output of the bureau financed by a compulsory tax rather than sold in the market at a per unit price, but also the bureau may have legal sanction as the sole producer in a particular market. As such, the public bureau attains a type of monopoly power not available in the private sector--the private sector monopolist has no way of compelling purchase of the good over which it has monopoly power.

The natural outgrowth of this institutional environment is that the bureau has tremendous control over the production of information.[2] In essence, voter-taxpayers lose the automatic and reliable price and profit signals which are generated by the competitive market process as a means for evaluating the bureau's performance. Instead, in the presence of costly and imperfect information, voters rationally find themselves in the position of making decisions on the basis of the

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[1] See, in particular, William A. Niskanen, Bureaucracy and Representative Government; Richard E. Wagner, "Supply-Side Aspects of the Theory of Local Government"; Jack A. Stockfisch, "Analysis of Bureaucratic Behavior."

[2] For discussions of political ignorance as a rational response to costly and imperfect information, see Anthony Downs, An Economic Theory of Democracy, pp. 207-259; and Gordon Tullock, Toward a Mathematics of Politics (Ann Arbor: University of Michigan Press, 1967), pp. 100-114. For a discussion of the differences in incentives to utilize and, therefore, accumulate information in the private and public sector, see Robert Staaf, "Limits to Rational Ignorance: Markets versus Governments," (Mimeographed, Virginia Polytechnic Institute and State University, 1976).

most readily available information. As it is the bureau that is funded to generate information on its own performance, it quite frequently becomes the dominant source of information on existing and alternative products and prices. Moreover, because of the typically wide sharing of tax costs and, therefore, dispersed "ownership" of the bureau, the incentive to actively monitor its activities is reduced dramatically.[1]

The means by which active bureaucrats can "profit" from their monopoly power are many, amongst which are the provision of selectively biased information made available to resident-voters; the drafting of legislation which ties popular program changes to a complex "technical" array of institutional changes to enhance their monopoly power; the use of all-or-nothing offers to ensure passage of favorable legislation; and even the inefficient combination of resources.[2]

The implication of this approach is that public sector institutions and changes therein provide direct means of isolating the

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[1]See Richard E. Wagner, "Supply-Side Aspects of the Theory of Local Government."

[2]The impact of uncertainty on information manipulation by supply-side agents is examined in more detail by Gordon Tullock, Toward A Mathematics of Politics, pp. 100-132; and Randall Bartlett, Economic Foundations of Political Power (New York: The Free Press, 1973), pp. 70-75. See William Niskanen, Bureaucracy and Representative Government, for an elaboration on the use of all-or-nothing offers; and for an extension of this basic model, see Arthur T. Denzau and Robert J. Mackay, "Benefit and Tax Share Discrimination by Monopoly Bureaus," and Thomas Romer and Howard Rosenthal, "Political Resource Allocation, Controlled Agendas, and the Status Quo." See also, Richard E. Wagner, "Supply-Side Aspects of the Theory of Local Government," on the lack of an incentive structure which would induce bureaucrats to operate in the least cost way.

bureau from the market process and altering the distribution of net benefits from public sector activity. As such, the growth of government and the concomitant proliferation of government institutions is viewed as the byproduct of a largely unconstrained endeavor by supply-side agents to maximize their own "wealth."[1]

Regarding Social Security, the implication of supply-side models is that the institutional evolution of the program can be better explained as the gradual monopolization of the old-age insurance industry. Federal production and compulsory purchase from a single supplier were the initial means by which program advocates secured monopoly power and isolated themselves from the market process; the expansion of coverage and increases in the ceiling on taxable earnings served to shelter the monopoly; and the introduction of a redistributive benefit formula and the elimination of a fund in 1939 were means of differentiating the product from that attainable privately. In essence, each of these were direct means of reducing the efficiency-generating forces of competition and thus reducing the monitorability of the bureau's output. The rapid growth and redirection of the program were then simply the byproducts of: (1) the monopolization and bureaucratization of the old-age insurance industry which permitted a selective bias by information made available to resident-voters; and

[1]For two case studies of the impact of bureaucracy on the growth of public education, see E. G. West, "The Political Economy of American Public School Legislation," and Robert J. Staaf, "The Growth of the Education Bureaucracy: Do Teachers Make a Difference?"

(2) the creation of a program with income redistributive potential in which the interests of special interest, beneficiary groups became increasingly coincidental with those of the bureaucracy.[1]

Just as was the case with employing the pure demand-side approach, unanswered questions arise. Foremost, what accounts for the delay in creating Social Security? Indeed, the United States was the thirtieth country in the world to enact compulsory old-age insurance--more than forty-five years after social insurance emerged in Europe and, importantly, six years after the onset of the Great Depression in the United States. Moreover, is it conceivable that a society with traditionally strong reliance on a market system and individual responsibility within this sphere of economic activity would tolerate the creation of government institutions that would increasingly invade the realm of private sector activity and thus permit massive wealth transfers within and between generations?

Limitations and the Need for Integration

It should be evident that the two approaches generate two quite different views of government activity and changes therein. In fact, the two approaches differ fundamentally according to the assumed delineation of rights of the collectivity (majority coalitions and the bureaucracy) and, therefore, according to the meaning of

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[1] For a similar view of Social Security, see F. A. Hayek, The Constitution of Liberty (Chicago: University of Chicago Press, 1960), pp. 285-305.

private ownership claims.[1] Demand-side models implicitly assume that the rights of the collectivity are clearly defined and the scope of its activities constrained so as to ensure an increase in the expected benefits from collective action, both across projects and over time. Alternatively, supply-side models conjure a collectivity which is largely unconstrained by the information generating forces of political competition; the rights of which are not clearly delineated. Within such a framework, the notion of private ownership claims takes on an entirely different meaning as governmental institutions, and changes therein, provide vehicles through which individuals' resources can be extracted by coalitions of demanders and suppliers without compensation.

In their pure or extreme forms, neither the demand- nor the supply-side approach can provide a generally applicable framework for non-market institutional change. In reality, governments fail to provide efficiently and automatically those public goods demanded; provide goods which are characterized by varying degrees of publicness; yet are not unconstrained by the voting process.

Observation of the collective choice process suggests that prevailing institutions must be viewed as the outcome of complex political interaction between active resident-demanders and active politician and bureaucrat-suppliers, recognizing differential information, reward to

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[1]The differences between the two approaches are discussed more fully by James M. Buchanan in The Limits to Liberty.

gathering information, and incentive to participate in the decision-making process on the two sides of the "market." Both suppliers and demanders have preferences defined over the institutional features of government programs as they affect the costs and benefits of their own actions. Individuals register preferences in their voter-taxpayer role through the ballot box or by lobbying; in their politician roles through their choice of Congressional committees and preferred policies; and in their bureaucrat role through administrative and judicial order, or by the formation and presentation of information and legislation.

What is needed is a means of bridging the gap between these two views and, in so doing, bridge the gap between the emergence of a relatively well constrained Social Security program in 1935 and the existence of what has been described as a huge, complex, "play-ball for vote-catching demagogues" that defies comprehensibility.[1] Rather than presenting a rigorous model, the following section presents an alternative view of the process whereby government programs evolve from demand-side origins to supply-side control.

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[1]F. A. Hayek, The Constitution of Liberty, p. 296. Other attempts to integrate both demand- and supply-side elements of the political process include Douglas C. Hartle, A Theory of the Expenditure Budgetary Process. Ontario Economic Council Research Studies (Toronto: University of Toronto Press, 1976); Randall Bartlett, The Economic Foundations of Political Power; and Albert Brenton, The Economic Theory of Representative Government (Chicago: Aldine Publishing Co., 1974).

Institutional Evolution: From Demand-Side Origins to Supply-Side Control

> Institutions evolve, but those that prosper and survive need not be those which are "best," as evaluated by the men who live under them. Institutional evolution may place men increasingly in situations described by the dilemma made familiar in modern game theory.[1]

An alternative view of non-market institutional change is presented in this section and is employed in the remainder of the study as a conceptual framework within which to view the emergence, redirection, and growth of Social Security.[2] It is suggested that once a new government bureau is created, the existence of imperfect information and uncertainty which characterize choice in the public sector, provide an environment conducive to a gradual erosion of constraints on majority coalitions and the bureaucracy. The implication of this framework is that over the life of the bureau these constraints are less likely to produce the determinate outcomes characteristic of pure demand-side models and, moreover, that institutional change may be better viewed

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[1] James M. Buchanan, The Limits to Liberty, p. x.

[2] For four alternative views of institutional change, see Lance Davis and Douglass North, Institutional Change and American Economic Growth; Anthony Downs, Inside Bureaucracy; Joe Reid, "Understanding Political Events in the New Economic History," Journal of Economic History (forthcoming); and Jonathan R. T. Hughes, "Transference and Development of Institutional Constraints Upon Economic Activity," (Mimeographed, Northwestern University, 1976). Whereas Downs examines bureau growth almost exclusively from the supply-side, North and Davis and Hughes examine the emergence and growth of government institutions and non-market controls almost exclusively from the demand-side. Reid presents a preliminary discussion of the importance of attitudes and institutions on non-market or political outcomes.

as the outcome of an evolutionary process from demand-side origins to supply-side control. An understanding of the process by which a single government bureau emerges and develops should provide insight into the broader question of public sector growth.

The key elements of this framework for institutional evolution are:

(1) The timing of emergence and the major objectives of a new government bureau can be explained largely as responses to broad-based citizens' demands.

(2) The specific institutional features which characterize the original program, however, are strongly influenced and, for the most part, determined by supply-side agents.

(3) Demand-side control over the program becomes more costly as the array of means to attaining program objectives expands and as the public sector, in general, grows.[1]

(4) The political costs of redirecting and expanding the program, once in existence, decline over time.[2]

(5) Supply-side pressures dominate demand-side pressures in changing the initial institutional arrangements so that, over time, supply-side models become increasingly descriptive of observed phenomena.

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[1] This point has been made by Anthony Downs in Inside Bureaucracy.

[2] Although their demand-side explanation is quite different than the one presented, Lance Davis and Douglass North make this point in Institutional Change and American Economic Growth, p. 44.

Since all governmental activity redistributes income, a reasonable premise from which to examine institutional change is that there always exists a "demand" for more government. At what point do these typically narrow demands give way to broader-based citizens' demands and ultimately to political action? Whether it be the result of actual or perceived changes in the economic environment and, therefore, changes in the relative costs and benefits of government action, we would expect that new government programs would emerge fairly spontaneously in response to broad demand-side pressures, and, in large part, be designed to obtain the objectives demanded. The spontaneity of response is deduced from the profit motive, no different than in the private sector. Legislators, acting as "political entrepreneurs," seek to provide the good that most nearly approximates that demanded by the participating majority.[1]

As suggested by the above framework, voter-residents acting through elected representatives will possess the greatest control over government institutions at the time of their emergence. In order for this control to approximate that which is characteristic of pure demand-side models, however, either information on the impact of

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[1]For an early discussion of political entrepreneurship, see Anthony Downs, An Economic Theory of Democracy, pp. 164-206. See also, Richard E. Wagner, "Pressure Groups and Political Entrepreneurs: A Review Article," Papers on Non-Market Decision-Making, I (1966), pp. 161-170; and Norman Frohlich, Joe A. Oppenheimer, and Oran R. Young, Political Leadership and Collective Goods (Princeton: Princeton University Press, 1971).

proposed changes must be readily available, or the expected impact of the proposed change must exceed the costs of obtaining information and transmitting voter demands.

Indeed, an important phenomenon associated with representative democracies in a world of imperfect and costly information is that the individual voter generally has a relatively small expected gain from investing in information accumulation and in voting.[1] This is the result of the quite different choice setting within which the voter operates as compared to that of private markets. Not only can he not, through an iterative procedure, choose the array of institutional features he most prefers, but also he has very little assurance that his most preferred bundle among a given set of alternatives will emerge from the majority voting process. Moreover, having little or no responsibility for the outcome of the voting process, the incentive to invest resources in reaching an informed decision or even in voting at all may be very low.

On the other hand, it is at the time when new government programs are being actively debated in Congress and in public that the costs of obtaining at least general information on proposals can be expected to be relatively low, while the incentive to participate

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[1]See James M. Buchanan, "Individual Choice in Voting and the Market," Journal of Political Economy, LXII (August, 1954) 334-343; Anthony Downs, An Economic Theory of Democracy, pp. 36-50, 82-95; Gordon Tullock, The Mathematics of Politics, pp. 100-114; and Robert Staaf, "Limits to Rational Ignorance: Markets versus Governments."

might be quite high. As legislators, bureaucrats, and advocates clamour to gain political support for their proposals, information is generated on alternative proposals. The potential bureau and objectives of the new program are both highly visible and relatively well defined. The availability of this information and the knowledge that the introduction of new government programs generally bestow large uncompensated losses as well as windfall gains raises the likelihood that citizens will participate in the collective choice process.

While political competition, an information-generating process, helps ensure that the new government program emerges in response to broad demand-side pressures and that it will be broadly designed to achieve the objectives demanded, the fiscal institutions which characterize the original program can be explained largely by supply-side factors. With respect to specific institutional features, information and therefore control are on the supply-side. Any number of taxes applied differentially to various voter groups can be chosen to raise revenues; the program can be financed by earmarking or general revenues; the distribution of benefits and the organizational pattern of the new bureau can take on many forms. Most frequently, this sort of legislation reaches Congress in "packages," inclusive of tax, expenditure, and administrative plans, to be voted upon as packages. Who plays the dominant role in formulating these packages of institutional features? Certainly it is the relatively small group of "experts"--those advocates, legislators, and potential bureaucrats who have invested heavily in organizing support and preparing proposals, and have an expected income or utility flow associated with support, passage, and future growth of the program.

The question arises, of course, why opponents are not just as effective in offering competing proposals, or competing sources of information. The answer lies in an understanding of the costs and rewards of lobby activities.[1] Specifically, economic theories of lobbying predict an underinvestment in resources devoted to lobbying for or against government programs for which the benefits are shared collectively. While the direct costs of lobbying by opponents include the time and effort involved in such activities as accumulating and disseminating information, and in drafting legislation, what are the benefits? Importantly, there may be no direct benefits to the opponent that are not shared equally with all other opponents. Effectively blocking the new government program secures benefits for opponents, whether or not they participate in sharing the costs. The familiar free-rider problem arises and an underinvestment in lobbying against the government program is expected.

How does this differ from the lobby activities of advocates, as surely there are direct costs to the individual and the benefits of

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[1] See Gordon Tullock, "The Paradox of Revolution," Public Choice, XI (Fall, 1971):89-99; Richard Auster, "The GPITPC and Institutional Entropy," Public Choice, XIX (Fall, 1974):77-83; and Peter H. Aaronson and Peter C. Ordeshook, "A Prolegomenon to a Theory of the Failure of Representative Democracy," (Mimeographed, Carnegie-Mellon University, 1976).

the new government program are shared collectively? The important difference is that advocates can expect to enjoy large direct benefits to their lobbying activities. Unlike an opponent, there may be benefits to the individual alone that are contingent upon his "lobbying," or exhibiting active support for the new program: a job in the newly created bureau, a staff position in Congress, an expanded realm for an existing agency, jobs for students and colleagues, consulting and research possibilities, to name a few. In addition, advocates of government activity are not infrequently employed in the types of occupations that facilitate, if not fund, research in support of government activity (government agencies, social work, labor unions, universities, etc.) thus reducing the direct costs to the individual. In sum, advocates have a very clear incentive not only to gather information, but also to take an active role in disseminating it; for indeed, they embody, in any real sense, early supply-side pressures for government action.

Given that these early supply-side pressures tend to be disproportionately represented, how does this affect the decisions ultimately made by citizens and their elected representatives? First, in the presence of imperfect and costly information, both citizens and their representatives will be susceptible rationally to information made available at another's expense. As such, uncertainty concerning the impact of alternative proposals or budgetary decisions on the individual or on the representative's constituency provides an environment conducive to influence and persuasion by these active participants.[1] Second, the fact that the rational politician is interested in retaining his elected position with the least possible expenditure of resources suggests that he need not respond to "broad-based" citizen demands unless they correspond to the demands of the most active and intensely interested voters--those whose support might determine an election.

Not barring significant ideological motivations, then, advocate-experts have strong incentive to participate actively in the collective choice process. Not only is it from the ranks of the overlapping group of advocates, bureaucrats, and legislators that persons are drawn to create and sponsor new government programs, but also it is generally from this group of "experts" that newly created bureaus are staffed. Indeed, it was the reliance of Congress on expert-advocates in 1935 that led one opponent of compulsory old-age insurance to say:

> No careful and intelligent observer in these unhappy times can have failed to observe that this has ceased to be a government in which legislation is by congressional action and vote, but has become a government by experts. . . A man who feels himself qualified to participate in the formulation of legislation, to have any voice in its formulation, should not offer himself for election to the Senate or the House of Representatives, but he should procure for himself a position as a member of some commission, or as an employee of some commission, or as an employee or agent of some bureau of the Government.[2]

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[1]See, in particular, Randall Bartlett, The Economic Foundations of Political Power, and Gordon Tullock, The Mathematics of Politics, pp. 115-132.

[2]Statement by Senator Clark (R.-Mo.); see Cong. Rec. 9627 (1935).

When one takes account of the reliance on expert-advocates for the drafting of legislation and staffing of new bureaus, it is not difficult to explain the observance of groups of advocates who invest quite heavily in organizing and rallying support for new government programs years before they are politically feasible from the demand-side. Moreover, their control over information helps explain the apparent paradox whereby a new program can emerge in response to changes in citizens' demands while its institutional features may be deduced only in part from these demands. It is, in fact, most frequently the case that in public discussion, advocates rationally promote a concept rather than an array of specific institutional features. It is said that the new program is needed to inject "safety," "security," or "stability" into an imperfect market economy. These emotionally and politically appealing, but ill-defined, concepts can thus be met by the broad objectives of the new program while being tied to less appealing institutional features in a complex package. Indeed, the extent to which most citizens will care to register their preferences at all will probably not exceed an expression of approval or disapproval of the major objectives of the new program, for unless they expect to incur major losses or gains by enactment, this will be the type of information most readily available and easiest to convey.

The institutional "details" of the new program and the bureau designed to administer it are of utmost importance to their survival and growth, for the ability of the bureaucracy to affect fiscal outcomes depends critically on the degree to which they become isolated from competitive forces. In most cases, government programs are financed by a compulsory tax or set of taxes. As such, purchase of the government output is compulsory. In other cases, the consumption of the output is compulsory as well. The introduction of a compulsory program that compels purchase from a single supplier necessarily reduces the information and efficiency generating forces of competition from both the private and local public sectors. By narrowing the range of alternative sources of supply available to voter-taxpayers and, in some cases, by eliminating voluntary patronage flows between private and public producers as an indicator of social value, comparative information on existing and alternative price-output bundles is reduced.[1]

Concomitant with the monopolization of an industry, then, the advocates' control over the production of information is increased many-fold. Whereas advocates may have been in the position of footing their own time and money costs of lobbying prior to the creation of the program, advocates within the bureau are now federally funded to undertake research, disseminate information, initiate and draft legislation, and even evaluate their own performance. They are in the

[1] For empirical studies which show a significant cost differential attributable to public provision, see Robert M. Spann, "Public versus Private Provision of Government Services," in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 71-89; Roger Albrandt, "Efficiency in the Provision of Fire Services," Public Choice, XIII (Fall, 1973; and David G. Davies, "The Efficiency of Public versus Private Firms: The Case of Australia's Two Airlines," Journal of Law and Economics, XIV (April, 1971).

position of determining not only what is studied and proposed, but also what is not. Quite frequently, in fact, the bureau becomes the dominant source of information on existing and alternative programs. The desirability of this development, from the point of view of program advocates, is stated most succinctly as follows:

> Freely available information naturally doesn't afford those who possess it any advantage. Therefore, influence is maximized by obtaining exclusive access to sources of information and by securing the position of exclusive supplier of it to those who make policy.[1]

In essence, the absence of private producers of viable substitutes makes possible a selective bias in information made available to resident-voters. Large public information services associated with government bureaus nearly always place disproportionate weight on the benefits produced by the program while directing attention away from the costs. Unlike the purchaser of a good in the private sector, the voter has no immediate access to information on individualized costs and benefits.

Even though the cost-reward structure of the public bureau is such that it motivates the individual bureaucrat to support expansionary policies, since new bureaus are generally staffed at the policy-making level by existing bureaucrats and program advocates--those with exhibited interest in and knowledge of the program and

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[1] Douglas G. Hartle, A Theory of the Expenditure Budgetary Process, Ontario Economic Council Research Studies (Toronto: University of Toronto Press, 1976), p. 82.

its administration--internal supply-side pressure for expansion is ensured.[1] This intial staffing-screening process, coupled with Civil Service laws that shield bureaucrats from political competition, not only rewards advocates for creating a political atmosphere conducive to political support for the program and for packaging successfully their proposals, but also institutionalizes expansionary forces.[2] As such, the establishment of the initial bureaucracy, regardless of its absolute size, combines expansionists of two types: those who based on personal values seek governmental control over a particular sphere of activity or an extensive public sector per se, and those who find their future "incomes" tied to the program's growth.

Although the monopolization and bureaucratization of some sphere of economic activity facilitates supply-side encroachment in the collective choice process, the process of eliminating competitive forces can be expected to be a gradual and imperfect one. It is for

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[1] For an example of a particular cost-reward structure and its likely impact on educational expenditures, see Robert Staaf, "The Growth of the Educational Bureaucracy: Do Teachers Make a Difference?" in Budgets and Bureaucrats, ed. Thomas E. Borcherding, pp. 148-168. For a more general discussion, see William Niskanen, Bureaucracy and Representative Government; and Richard E. Wagner, "Supply-Side Aspects of the Theory of Local Government," and Roland McKean, "The Unseen Hand in Government," American Economic Review, LV (June, 1965): 496-505.

[2] For an empirical study of the impact of Civil Service on public spending in state and local governments, see Thomas E. Borcherding, Winston C. Bush, and Robert M. Spann, "The Effect on Public Spending of the Divisibility of Public Outputs in Consumption, Bureaucratic Power, and the Size of Tax Sharing Groups," in Budgets and Bureaucrats, ed. Borcherding, pp. 211-227.

this reason, that the early years in the life of the bureau are particularly critical, as these are the years still marked by threats to survival by the market alternative.[1] Indeed, since the functions and scope of the original program can be expected to be relatively narrow, the bureau's role as a producer of public information will be all the more important, particularly if the program had intense opponents.

While this might suggest some degree of voter control during the early years, it is certainly the case that time is on the suppliers' side. As voter-taxpayers discount the losses associated with government intervention and the creation of the new program, the incentive to lobby against costly program changes that only affect marginally the taxpayer's total tax bill is reduced. Moreover, as the program becomes just one more in an array of government programs with multiple finance and expenditure schemes, the cost to the voter and his representative of obtaining accurate information increases.[2] For both of these reasons, we would expect that the relatively well informed participation in the voting process, characteristic of the emergence of the new program, would give way to reduced voter participation rates and decisions made on less accurate information. The political costs of redirecting and

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[1]Anthony Downs refers to an "initial survival threshhold" that the bureau must surpass to attain autonomy; see Inside Bureaucracy, pp. 7-10.

[2]For an empirical study of the impact of complex revenue structures on public sector outcomes, See Richard E. Wagner, "Revenue Structure, Fiscal Illusion, and Budgetary Choice," Public Choice XXV (Spring, 1976):45-65.

extending the program, thus, decline so that suppliers are in the position to effect institutional changes that will facilitate growth of the program.

Having secured the type of monopoly power previously described, the bureau has any number of ways, depending upon the particular nature of the program, to "profit" or bias budgets upward. Indeed, by controlling information regarding its output and costs of production, and by playing the major role in the drafting of legislation, the bureau is in a particularly favorable position to make effective all-or-nothing offers to its Congressional review committee--offers which can take on any forms. Whether the bureau chooses to tie popular program changes to an array of institutional changes which would enhance its monopoly power, or to complex changes in the distribution of tax costs and expenditures in order to affect political demands, or whether it simply extracts too large a budget, it is in the position to utilize standard monopoly practices to insure passage of issues which on their own, in a competitive setting, may have stood little chance of passage.[1] Importantly, however,

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[1]See supra, p. 13; see also, James M. Buchanan, "The Economics of Earmarked Taxes," The Journal of Political Economy, LXXI (October, 1963):457-469; and Richard E. Wagner and Warren E. Weber, "Competition, Monopoly, and the Organization of Government in Metropolitan Areas," on the impact of fiscal institutions on the monopoly position of the bureau.

> . . . the power and the influence of bureaucracy over budgets rests more in the suppression of information, particularly about alternatives, than in its ability to push through changes that [voters] do not like.[1]

Regarding the types of policy "recommendations" that will likely eminate from the new bureau, it should be expected that every effort will be made to expand the realm and complexity of its activities. Again, this need not be the result of any perverse motivations on the part of government employees, but simply the drive to better one's position, to gain discretion over one's actions, in essence, to attain monopoly power. Each expansion of the program makes further inroads into the market economy while at the same time bestowing redistributed gains to the beneficiaries of program expansion. In addition, an increasingly complex program, one whose details can only be mastered by "experts," increasingly removes the bureau from direct voter control and increases reliance on bureau-generated information.

The pursuit of this sort of complex program is a rational policy on the part of both bureaucrats and legislators and, as such, is a particularly difficult occurrence to constrain. In essence, a complex program not only disguises the program's typically narrow distribution of net benefits and generally dispersed tax costs, but also makes the program particularly susceptible to political demands to exploit the redistributive potential of such a program.

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[1]Douglas G. Hartle, _A Theory of the Expenditure Budgetary Process_, p. 82.

From the point of view of politicians, complex programs and complex program changes place them in the position of voting on "key" issues--generally expansionary issues--leaving it to the experts to decipher the array of technical changes to which they have been tied. Given that additional expenditures can generally be financed by a relatively small adjustment in each individual's total tax bill, the incentive for taxpayer groups to invest resources in opposing costly expansion can be expected to be quite small. Moreover, should these additional expenditures be financed along with most other government programs out of general revenues, it may be virtually impossible for the individual to isolate the incremental tax cost associated with any particular policy change. On the other hand, beneficiary groups have a significantly larger incentive to lobby for expansion because of the relatively large direct gains to the expansion of a program with typically localized benefits.

Recognizing the tendency for beneficiary groups to dominate lobby activities, it is a straight-forward matter to explain why Congressmen benefit from complex redistributive programs. Simply stated, the individual Congressman is in a better political position after having worked to improve the lot of a coalition of actively participating beneficiaries than to have made marginal improvements in the lots of a vast majority of taxpayers. It is for precisely this reason that Congressional review committees tend to be staffed disproportionately by representatives of high demand special interest groups, with a resulting lack of effective constraints on the expansionary demands of the bureau.[1]

The susceptibility of a complex, redistributive program to political demands for exploitation is desirable from the point of view of bureaucrats as it legitimitizes their demands. In essence, the demands of expansionist beneficiary groups become increasingly coincidental with the "recommendations" of the bureau. In both cases, their contributions to public funds necessary to finance a growing public sector are well outweighed by their direct financial reward. As such, just as in the private sector, those that actively pursue a particular course of action and to whom resources generally flow, are those that value them most highly. Quite unlike in the private sector, however, those individuals for whom the net benefits of government action are the greatest may be those who actually bear the least costs.[2]

Importantly, then, as the bureau becomes removed from the competitive market process so that voters lose automatic and reliable signals for evaluating the public product, and as voter participation

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[1]Niskanen makes this point in Bureaucracy and Representative Government.

[2]In the words of Alexis de Tocqueville, ". . . a democratic government is the only one in which those who vote for a tax can escape the obligation altogether," in Democracy in America, ed. J. P. Mayer, translated by George Lawrence (Garden City, N.J.: Doubleday and Co., 1969), p. 210.

rates decline, outcomes of the majority voting process become increasingly non-democratic. Indeed, an erosion of constraints on the bureaucracy concomitant with the monopolization of an industry tends to go hand-in-hand with an erosion of the constraints on majority coalitions.[1] As the bureau, using public funds, actively publicizes the inherent "publicness" or "social gains" of their program, while maintaining discretion over institutional redesign, massive wealth transfers can be effected by simply permitting the majority voting process to run its course. "Technical changes" in the distribution of benefits that bestow special treatment to deserving beneficiaries generate effectively demands for expansion to eliminate the seeming "inequity." Rules and regulations made applicable to only one market, in a complex interrelationship with other markets, are generally ineffective and, therefore, generate demands for the proliferation of rules into other markets in order to achieve the original objective. Without rules to delineate the rights of majority coalitions, there may be, in fact, no logical limits to the public domain.

Over the life of the bureau, then, there are two primary sources of bias which tend to reinforce its prospects for survival, growth, and supply-side dominance:

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[1]For a discussion of the importance of constraints or rules on majority voting, see James M. Buchanan, The Limits to Liberty, F. A. Hayek, The Constitution of Liberty, pp. 103-117; and Alexis de Tocqueville, Democracy in America, pp. 250-260.

(1) The isolation of the bureau from the competitive market process which permits a selective bias in information made available to resident-voters.

(2) The disproportionate representation of expansionary special interest groups made possible by imperfect tax institutions with a resulting inability to temper demands for redistribution.

Optimistically, of course, there does exist the possibility of a demand-side control cycle over the life of the bureau so that the process of increasing bureaucratic control need not be viewed as continual and unchecked. Again, though, time is on the suppliers' side since, to a large extent, suppliers control relevant information and have vested interests in opposing any reform measure that would reduce their discretionary power. Unlike in the private sector, individuals may be compelled to purchase a good for which the tax cost exceeds the benefits. A majority of net losers is not even sufficient to evoke institutional change. It is not until a majority of resident-voters perceive net losses and organize for change that a true demand-side reform proposal can be effected. It is at this time that competing sources of information must surely have reemerged, and marginal increments in individuals' tax bills turned into discrete changes, reinstilling the elements of demand-side control.

More frequently, however, there appear to be cases in which bureaucratic suppliers maintain control over time with growing dominance.

In such cases, we thus perceive institutional evolution from demand-side origins to an apparently unchecked supply-side dominance, the impact of which is enhanced by bureaucratic franchise.[1]

A Brief Overview of the Study

Using the conceptual framework developed in the previous section, the remainder of this study is devoted to an examination of the emergence, growth, and redirection of Social Security. By recasting and reexamining traditional views of the evolution of Social Security, insight may be gained into not only the prospects for reforming the Social Security system but also the more general phenomena of government growth. As a preliminary step, a brief overview of the study is contained in the remainder of this chapter.

The Lack of Broad-Based Demands for Compulsory Old-Age Insurance in the Pre-Great Depression Years

It is the central purpose of Chapter II to determine if significant and broad-based demand-side pressures for a centralized, compulsory old-age insurance program existed at any time prior to the Great

[1] Rather than suggesting that voters fail to learn and are, therefore, irrational to permit the creation of such government institutions, this view of institutional evolution makes it all the more likely that they will participate quite actively at the time of emergence. Indeed, the voter who has learned will likely endeavor actively to institutionalize constraints in the new program. On the other hand, the voter who has learned will undoubtedly discount the future course of the program at the time of creation, thus lowering the incentive to participate in controlling the bureau over time.

Depression. Alternatively, were there clear trends developing that would have likely culminated in the introduction of compulsory old-age insurance in the early 1930's? Adequate answers to these questions should be of interest in and of themselves. But, more importantly, the answers to these questions will condition the assessments one makes of the significance of the Great Depression, President Roosevelt, and an active array of social reformers in determining the timing, the acceptance, and the form in which "social insurance" was institutionalized in the Social Security Act of 1935. These assessments are the subject of the next chapter; the logically prior questions are the subject of this chapter.

To address these questions, this chapter examines the general political and economic climate of the United States prior to the Great Depression. Particular emphasis is placed on a detailed examination of the histories of private, individual and cooperative, and governmental responses to the problems of both old-age poverty and old-age financial insecurity. The evidence presented in this chapter clearly suggests that not only were there no broad-based demands for compulsory old-age insurance but also there were no clearly discernible trends that would have likely led to the development of such pressures by the mid-1930's.

The lack of broad-based demand-side pressure for compulsory old-age insurance is evidenced by four identifiable phenomena. First, the prevalent philosophy of "individualism" led to a careful distinction between the problems of old-age poverty and old-age financial insecurity and called for quite different institutional responses to each. Second, the private problem of old-age insecurity was being attacked by a rapid growth and proliferation of private means of savings and insurance which began in the latter decades of the nineteenth century and continued nearly uninterrupted through 1929. Third, the problem of old-age poverty was being attacked by an old-age pension movement which emerged in the early 1920's to provide welfare to the needy aged at the county level. Rather than complementing the demands of social insurance advocates, the old-age pension movement threatened and eventually crippled the social insurance movement during the prosperous 1920's. Finally, there was a clear failure on the part of social insurance advocates and other social reformers to gain any political momentum for federal, compulsory old-age insurance prior to the Great Depression.

The Emergence of Social Security: The Impact of the Great Depression, President Roosevelt, and Social Insurance Advocates

Given the findings in Chapter II which indicate a lack of broad-based demands for compulsory old-age insurance prior to the 1930's, it is the central purpose of Chapter III to determine what the underlying economic and political changes were that led a majority of elected representatives to support a compulsory, federal system of old-age insurance in 1935. Alternatively, the chapter examines whether or not pure demand-side models of public sector activity can adequately explain the timing, acceptance, and form of social insurance in the United

States. Indeed, as late as 1934, no bills for compulsory old-age insurance had been introduced into Congress.

It is to this phenomenon that Chapter III is addressed. What were the key factors accounting for the rapid enactment of the law? What was the impact of the perceived failure of private markets on demands for government action? Moreover, what were the key factors influencing the institutional design of the old-age insurance program? More specifically, what was the impact of President Roosevelt's appointment of a Committee on Economic Security which was independent of Congress in drafting the proposed legislation? What was the impact on the ultimate design of the new law of staffing this Committee with existing bureaucrats and social insurance advocates?

To address these questions, this chapter examines the general economic and political climate between the onset of the Great Depression in 1929 and the emergence of social insurance in 1935. To provide insight into the political atmosphere that gave rise to the Act, the chapter is devoted in some detail to the drafting of the law, the major issues of debate, and seriously considered alternative proposals.

The evidence presented in this chapter suggests that while the major objectives of the Social Security Act, in particular, poverty alleviation, were supported by broad-based citizen's demands, the institutionalization of compulsory old-age insurance was not the outcome of a competitive or democratic political process. Whereas the perceived failure of private savings and insurance institutions and the dramatic increase in unemployment concomitant with the onset of the depression certainly led to a reevaluation of the relative costs and benefits of government action, thus generating an environment conducive to the emergence of new government institutions, there remained many ways that these demands for "security" could have been satisfied--ranging from federal-state welfare programs to subsidized, or insured private insurance plans.

Given these demands, the control over information maintained by President Roosevelt, the Committee on Economic Security, and other social insurance advocate-"experts," and their ability to tie the creation of a series of politically popular federal-state welfare programs to the enactment of compulsory old-age insurance permitted the passage of a federal old-age insurance program that alone clearly would not have gained passage during the 1930's. As such, the fact that the original old-age insurance program, as it emerged from Congress, had several attributes of private insurance and was relatively narrow in scope should be viewed not so much as the outcome of a democratic compromise between the demands of opponents and the demands of advocates, as the outcome of a political process in which the agenda was controlled.

The Institutionalization of Expansionary Forces, Program Redirection, and the Elimination of Institutional Constraints on Income Redistribution: 1935-1960

Only four years after the original Social Security Act was passed, the most radical redirection in the history of the program had been accomplished, rendering the private insurance analogy no longer applicable. Both the goals of individual equity and funding had been dismissed for the attainment of "social adequacy" goals and a pay-as-you-go system. Enacted before any monthly benefits had been paid under the old-age insurance program, the 1939 Amendments marked the first redirection and expansion of the program that had been "recommended" by Social Security officials, endorsed by the Advisory Council on Social Security, and demanded by special interest groups.

In the following twenty years, the metamorphosis of Social Security from a limited objective old-age insurance program to a broad-scale and complex redistributive scheme had been virtually completed. By 1960, benefits were being distributed on a pay-as-you-go basis to multiple beneficiary groups with diverse age and eligibility requirements, and the complexity of the program had increased to the point that bills to amend the Act, of which hundreds were introduced into each legislative session, numbered hundreds of pages. Moreover, coverage was all but universal and there were two new social insurance programs distributing benefits to survivors, dependents, and the disabled. In essence, the three major objectives of the original program--funding, benefits directly related to earnings payable to worker-taxpayers only, and limited coverage--had been eliminated.

Given the apparently limited nature of the old-age insurance program in 1935 as well as its lack of broad-based political support, how can this evolution to a highly complex, redistributive program be explained? This question is the major concern of Chapter IV. Several other questions are also addressed as they provide economic and political insight into this broader phenomenon. For example, recognizing the importance of supply-side control over the original institutional features of the old-age insurance program, can this later course of events be explained by simple supply-side models? If the bureaucracy did dominate the evolution of the program, what were its sources of power and how was it able to overcome the initially intense opposition to compulsory old-age insurance? How was it able to shield itself from competitive pressures from the local public and private sectors? What were the revealed political strategies for expansion of the program? What was the impact of both eliminating the fund in 1939 and expanding coverage in the 1950's on the monopoly power of the bureau and the ability to employ the program to redistribute income? Indeed, can the evolution of the program from 1935-1960 be explained as the outcome of an active bureaucracy influencing the forces that generate income redistribution?

To address these questions, Chapter IV undertakes both a detailed examination and evaluation of the impact of the creation and staffing of the new bureau, the policy recommendations forthcoming from the bureau and its advisory councils, the political demands on the system, and the institutional evolution of the program between 1935-1960.

The evidence presented in the chapter suggests that two early developments were particularly crucial to the rapid growth and institutional proliferation of Social Security; in particular, the monopolization of the old-age insurance industry which would permit a selective bias in information made available to resident-voters, and the creation of a program with income redistributive potential to which millions of Americans would become direct beneficiaries of public funds. Whereas the monopolization of old-age insurance took place to an important extent with the enactment of the law in 1935, the creation of a largely unconstrained institutional apparatus for income redistribution is attributed to the amendments of 1939. Changes in the distribution of benefits and the means of financing complicated the program, thus rendering demand-side control of the program more costly; redirected it from its initial insurance objectives; and by eliminating constraints on income redistribution, set the stage for the growth the program has since experienced. In essence, the amendments both buttressed the monopoly position of the new bureau and therefore its control over the production of information, and contributed to the emergent susceptibility of the program to expansionary demands for income redistribution. In many ways, the history of the program since that time evidenced most clearly the difficulty of constraining program expansion and redistribution when the demands of special interest-beneficiary groups became increasingly coincidental with the interests of the bureaucracy.

The Exploitation of the Redistributive Potential and the Growing Complexity of the Program: 1960-1975

Although the entire legislative history of the Social Security program can be described as the gradual redirection and expansion of the limited objective old-age insurance program, there are certain important differences between the periods 1935-1960 and 1960-1975. First, unlike the new insurance titles introduced prior to 1960, the 1960's witnessed the emergence of a new social insurance program, hospital insurance, for which the objectives were contrary to those of the original Social Security program. The program was rationalized on poverty-alleviation grounds rather than on poverty-prevention grounds, and benefits were explicitly designed to be distributed independently of earnings and taxpayments, rather than earnings-related. Second, the Kennedy-Johnson years elevated domestic policy, especially Social Security, to an annual political issue. The program was liberalized nearly every year between 1960-1975. Third, across-the-board benefit increases were enacted between 1960-1975 that increased benefits to current recipients six times bringing the real cumulative increase since 1940 to 150 percent. Prior to 1960, only four across-the-board benefit increases had been enacted, for a real cumulative increase of 32 percent. Indeed, whereas total real Social Security expenditures increased more rapidly during the 1950's than during any other decade, this represented an increase that was largely absorbed by new beneficiaries of the program. During the 1960's and early 1970's, on the other hand, the

165 percent increase in real expenditures was reflected in large direct gains to current beneficiaries.

As a direct result of program expansion and liberalization during the 1960's and early 1970's, rapid increases in the costs of the program were finally reflected in dramatic increases in individual tax-payments. Whereas the pre-1960 years were characterized by the rapid expansion of coverage which permitted a spreading of tax costs among individuals, by the 1960's, cost increases had to be absorbed by a less rapidly growing stock of covered workers. Between 1960-1976 alone, the real maximum tax payment increased 242 percent, reaching $1,790, as compared to a 93 percent increase in the preceding twenty years. Also, as Congress turned to real ceiling increases in lieu of large tax rate increases, the rapidly rising costs were borne more heavily by higher income workers.

By 1975, the financial future of the Social Security program had finally become a matter of serious political concern. In fact, rather than legislating further expansionary amendments during that year, Congress was devoting most of its attention to formulating politically feasible means of alleviating large trust fund deficits without jeopardizing the integrity of the many government "promises" outstanding.

It is the central purpose of Chapter V to address the question of what led to the political escalation of Social Security after the 1950's. Moreover, what economic and political factors help explain the introduction of large increases in real benefits payable under what had come to be known as an earnings-related "insurance" program? Why were additional expenditures financed increasingly by real ceiling increases rather than tax rate increases? In essence, what were the conditions or circumstances in the 1960's and early 1970's that led to a quite different set of political and institutional responses than had been the case in the first two decades of the program's history? To address these questions, Chapter V contains an in-depth discussion of not only the institutional changes actually enacted between 1960-1975, but also the economic and political causes and consequences of these institutional changes.

The evidence presented in the chapter suggests that rather than marking a "new awareness" on the part of Americans to the needs of the elderly, or an increasing preference for income equality within and between generations, the political escalation of Social Security was primarily the result of a marked change in the political power of beneficiary groups after the 1950's. Recognizing the relatively large incentive of beneficiary groups to participate actively in the collective choice process as well as the incentive of elected representatives to respond to their demands, this was the predictable outcome of a continued weighting of the age distribution toward the elderly, a significant increase in the proportion of the elderly receiving Social Security benefits during the 1960's alongside a rising proportion of recipients of all ages. Importantly, the introduction of a pay-as-you-go system in 1939 designed to make transfers predominately to the elderly had created a system in which these variables would be key determinants of the resulting redistribution and expansion.

Among the factors which help account for the increasing reliance on the program for intragenerational income transfers, the most notable were the ability to disperse oppressive state welfare costs through an expanded and liberalized "social insurance" program, and the ability to transfer the cost of additional Social Security expenditures onto a minority of higher paid workers through increases in the real taxable ceiling.

While it is clear that the resulting institutional changes were certainly not consistent with the objectives of the original Social Security program, there were few effective constraints on the ability to employ the program for these purposes. Indeed, there was no fund and, therefore, no obligation for current generations to finance their own future benefits. There were no rules to ensure that two worker-taxpayers with identical income streams received the same benefits upon retirement, and therefore, no obligation to restrict benefits to worker-taxpayers only. And, there were no voluntary patronage flows between the public producer and competing private producers that might have generated automatic and reliable means of evaluating the output and price of the public product.

Instead, there existed a program that had become far too complex to understand in its entirity, and the objectives of the program were no longer clear. Since the appropriate means of attaining an undefined objective were themselves poorly defined, almost any changes were defensible by Social Security bureaucrats and expansionist politicians. Without rules to define permissible fiscal outcomes that would have protected the rights of minority coalitions, the piecemeal program became particularly susceptible to exploitation, whether demanded by special interest groups or "recommended" by Social Security officials. Changes enacted one year to bestow particularly "deserving" groups of voters with special benefits were met in later years by demands for expansion and "uniformity." As representatives of the elderly, the poor, and organized labor became more dominant lobby groups, demands emerged for larger benefits and a redistribution of costs.

For each of these reasons, which are explored in more detail in the chapter, the Social Security program expanded to encroach upon traditionally state welfare activities, traditionally private insurance activities, and upon the rights of future workers. In essence, what has been observed in the past fifteen years was the predictable outcome of eliminating constraints on the demands of special interest groups while increasing supply-side control over information sources. The role played by the bureaucracy in these developments, particularly in reducing taxpayer opposition to costly program expansion, is seen as all the more important when one takes account of the fact that throughout this period, Social Security bureaucrats were publicly advancing the notion that the program was financed on the basis of funded reserve principles.

The "Fiscal Crisis" and Prospects for Reform

While there appeared to be no binding constraints on the ability of Congress to legislate indirectly large redistributions of income within and between generations during the Johnson and Nixon years, experience during the years 1975-1977 indicates that this is no longer the case. In fact, fairly widespread concern over the financial soundness of the system has led to a virtual halt in the creation of laws to liberalize and expand the program.

As of mid-1977, some four years after the Board of Trustees first announced the emergence of "unexpected" long-run deficits, no action had been taken to alleviate the deficits. This should not be surprising as many of the traditional means of extracting additional funds have been all but exhausted--tax rates are reaching what is thought to be their "politically acceptable" limit, coverage is nearly universal, and the ceiling on taxable earnings is above the level of 75-80 percent of all covered workers' earnings. This does not rule out the very real possibility that tax rates will be further increased (as the employers' share is often not recognized as a cost to the worker), the ceiling will be increased to cover all earnings, and that coverage will be made universal. Indeed, the demands of 32 million beneficiaries, many of the 100 million taxpaying workers who hope to become beneficiaries, lobbies representing the elderly and organized labor, Social Security officials, and other expansionists can hardly be offset by the warnings of fiscal conservatives. But, what would be the implication of these changes? They would be the admission of a complete dismissal of the institutional framework upon which the original program had been based; and the institutional redirection for the exploitation of a government program for redistributive purposes would have been essentially completed.

The concluding chapter of this study is devoted to an examination of both the sources of "fiscal crisis" and the prospects for reform. It appears evident that special interest groups, including the Social Security bureaucracy, have grown to include so many persons that broad demand-side reform, in an ideal sense, is impossible; yet for the first time in the history of the program, alternative sources of information are surfacing, without which rational choice would have been impossible.

Chapter II

THE LACK OF BROAD-BASED DEMANDS FOR COMPULSORY OLD-AGE INSURANCE: THE PRE-GREAT DEPRESSION PERIOD

Introduction and Summary

Purpose and Scope

It is the central purpose of this chapter to determine if significant and broad-based, demand-side pressures for a centralized, compulsory, old-age insurance program existed at any time prior to the Great Depression. Alternatively, were there clear trends developing that would have likely culminated in the introduction of compulsory, old-age insurance in the early 1930's? Adequate answers to these questions should be of interest in and of themselves. But, more importantly, the answers to these questions will condition the assessments one makes of the significance of the Great Depression, President Roosevelt, and an active array of social reformers in determining the timing, the acceptance, and the form in which "social insurance" was institutionalized in the Social Security Act of 1935. These assessments are the subject of the next chapter; the logically prior questions are the subject of this chapter.

To address these questions, this chapter examines the general political and economic climate of the United States prior to the Great Depression. Particular emphasis is placed on a detailed examination of the histories of private, individual and co-operative, and governmental responses to the problems of both old-age poverty and old-age financial insecurity. The evidence presented in this chapter clearly suggests that not only were there no broad-based demand-side pressures for compulsory, old-age insurance but also there were no clearly discernible trends that would have likely led to the development of such pressures by the mid 1930's.

Old-Age Poverty and Old-Age Insecurity Distinguished

At first this conclusion may seem somewhat surprising. Social insurance had been implemented in Germany in 1889, forty years prior to the onset of the Great Depression, and throughout Europe by 1929.[1] With these circumstances, one might have expected to see, at the least, the emergence of a growing demand for compulsory insurance in the United States well before the 1930's. Moreover, some might simply view the existence and increasing incidence of poverty amongst the aged throughout this period as sufficient evidence of the "need" for compulsory old-age insurance and, hence, likely to result in the "demand" for the program. This conclusion is not so surprising, however, if one clearly

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[1]See Table 12 for the date of enactment of major European programs.

distinguishes between the ex-post problem of old-age poverty or dependency--the problem of alleviating existing poverty amongst the elderly--and the ex-ante problem of old-age financial insecurity--the problem of preventing future poverty. With this distinction in mind, it is clear that the problem of old-age poverty may be addressed by an almost completely different set of institutional responses than the problem of old-age insecurity. Demands for government action in the one area do not necessarily imply that there are demands for government action in the other.

More generally, there are many ways of organizing human activity directed toward solving these financial problems of the elderly, both the ex-post problem of dependency and the ex-ante problem of insecurity. Human activity, in general, may be organized so as to draw upon, either singly or in combination, the following types of actions: purely individualistic actions; private voluntary, but jointly organized actions; and, coercive governmental actions.[1] In terms of responding to the financial problems of the elderly, purely individualistic actions would include continued employment in old-age and the accumulation of private savings and life insurance. Private voluntary but jointly organized actions would include financial assistance from the elderly's family, neighbors, or church; or from private charity, the formation

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[1]James Buchanan and Gordon Tulloch, The Calculus of Consent: Logical Foundations of Constitutional Democracy (Ann Arbor: University of Michigan Press, 1969), pp. 44-62.

of fraternal societies for mutual aid during periods of unemployment, sickness, or old-age, and the formation of industrial pension plans. Government actions would include the placing of legal requirements for financially supporting the elderly upon other persons, such as their immediate family; the provision through coercive taxation of old-age pensions (welfare or relief); and the establishment of compulsory savings schemes. Furthermore, government action can be either decentralized or centralized and the degree of coercion can vary over a wide range.

Institutional Responses to the Financial Problems of the Elderly

Throughout the eighteenth, nineteenth, and early twentieth centuries, the institutional responses to the financial problems of the elderly indicated that, unlike today, there was a very clear distinction drawn between the ex-post problem of alleviating existing poverty and the ex-ante problem of preventing future poverty.[1] On the one hand, the problem of old-age dependency was generally considered a social problem, but it is important to note, it was assumed that this particular problem would affect only a small proportion of the aged. On the other hand, the problem of financial insecurity in

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[1]This distinction is emphasized in National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, Inc., 1931), pp. 1-5; and Hace S. Tishler, Self-Reliance and Social Security: 1870-1917 (London: Kennikat Press, Inc., 1971), pp. 7-11.

old-age was considered a private or individual problem, and one that would affect most individuals of any age. In other words, the prevention of future poverty was considered an individual problem to be solved by individual planning and thrift or by continued employment in old-age. The prevention of future poverty was not considered to be a social problem requiring direct government intervention even at the most decentralized level. The state's role was limited to the creation of appropriate incentives for personal thrift; e.g., unattractive poverty relief. If the individual, for any number of reasons, failed to provide for old-age security then the problem of old-age poverty was to be handled by private voluntary actions, such as aid from family, friends, the church, or private charity, or government action undertaken at as decentralized level as possible, such as indoor or outdoor relief or laws imposing the burden of support of the elderly on their immediate families.

In short, the elderly population could be divided into three categories: a group that was self-supporting through savings or continued employment; a group that was dependent on family or some form of private charity; and a group that was dependent on public relief. Only the latter, residual group, was considered to be a "social" problem.

The history of public attitudes toward and institutional responses to the problems of old-age poverty and old-age insecurity in the years prior to the Great Depression reveal two significant trends.

Responses to Old-Age Poverty

For the former problem of old-age poverty, there was a gradual redefinition of the degree of publicness involved in old-age poverty. Throughout most of the eighteenth and nineteenth centuries, the institutional design of poverty relief was dominated by the self-help ethic. Public institutions for poverty relief, which were not restricted to any particular age group, were designed to discourage their use and encourage, instead, self-help. Eligibility requirements were stiff and the work required was unpleasant. The programs were organized and controlled at the most local level. As immigration and industrialization intensified in the late 1800's and early 1900's, public relief expenditures rose rapidly, but these public relief efforts were still secondary to the private responses to old-age dependency and insecurity: family, friends, church, fraternal societies, and private insurance and savings institutions.

Poverty amongst the elderly, however, was still a growing problem. In the early 1900's, periodic economic recessions, immigration, urbanization, industrialization, and a rising proportion of elderly persons all contributed toward elevating old-age poverty to a leading social issue in the 1920's. The public aspects of poverty became more dominant, and provision evolved from local responsibility, to county responsibility, to state responsibility.

There also developed during the prosperous 1920's a county-state old-age pension movement. A trend that would likely have culminated in some sort of federal involvement in old-age poverty relief was fairly clearly established by the late 1920's; but, federal control, without the disruptions caused by the Great Depression, would have been severely constrained by the strong states' rights sentiments of the time.

Responses to Old-Age Financial Insecurity

For the latter problem of old-age insecurity, there were no trends throughout this whole period toward government involvement. Instead, what is evidenced, most clearly perhaps in the 1870-1929 period, is the remarkable tendency of the private sector to react in a responsive and flexible manner to the changing economic conditions as they affected the material status of the elderly. As rapid urbanization and industrialization, characteristic of the turn of the century, threatened two important sources of old-age financial security--the family and continued employment--existing voluntary institutions for savings and insurance such as fraternal societies flourished. Also, new voluntary cooperative arrangements such as industrial pension schemes and life insurance emerged.

Between 1876-1892, the number of industrial insurance policies in force increased from 5,000 to 5 million; and by 1890, there were 126 establishment funds (insurance for all the workers in a plant), 100 of which were created in the preceding decade.[1] Fraternal

[1]Hace Tishler, Self-Reliance, p. 23.

societies, the oldest and at that time the largest source of voluntary insurance, continued to enjoy rapid growth during the latter part of the nineteenth century; and by 1893, this type of insurance policy was held by 3.7 million fraternal members.[1] While most of the early policies were for life insurance, they foreshadowed the emergence and growth of retirement insurance (pensions) near the turn of the century.

It is interesting to note, moreover, that as the economy became subject to periodic and serious economic recessions, the heightened risk of unemployment in old-age generated intensified private sector responses rather than demands for government action. In fact, it was during the 1890's, generally regarded as "one of the economically most troubled periods in our hisotry," that private savings and insurance institutions flourished.[2] The number of industrial insurance policies, establishment funds, and national labor union plans doubled, while the number of fraternal insurance societies increased 50 percent.[3]

As such, the histories of private, individual and co-operative, and governmental responses to the problems of both old-age poverty and old-age insecurity prior to the Great Depression reveal that a clear

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[1] Ibid.

[2] Quoted material by Milton Friedman and Anna Schwartz, A Monetary History of the United States: 1897-1960 (Princeton: Princeton University Press, 1963), p. 97.

[3] Hace Tishler, Self-Reliance, p. 69.

distinction was drawn between the two problems. They were considered to be two quite different problems: one a public concern, the other a private concern. The institutional responses to these problems that were chosen during this period, the emergence of county-state old-age pension programs preceding the Great Depression to attack the former problem alongside the growth of private savings and insurance institutions to attack the latter problem, provide an interesting contrast to the current Social Security Act with its confounded and dual welfare-insurance objectives. The responses chosen during that period were clearly consistent with the most prevalent philosophy of that time. The philosophy of "Individualism" embodied the principles of individual liberty, self-responsibility, open-market competition, an acceptance of the outcomes of this competition, and limited government.[1] This undercurrent of individualism, so characteristic of the pre-Great Depression period, was undoubtedly one of the most important factors accounting for the delay, relative to other industrialized nations, in the introduction of a federal, compulsory old-age insurance program in the United States.

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[1]For a discussion of this prevalent philosophy and its implications for the early social insurance movement, see Roy Lubove, The Struggle for Social Security: 1900-1935 (Cambridge, Massachusetts: Harvard University Press, 1968), pp. 1-24.

The Role of the Social Insurance Movement

Although there were no broad-based demand-side pressures for compulsory, old-age insurance prior to the Great Depression, there were certain advocate groups that attempted to build political momentum for either compulsory old-age insurance or federal old-age welfare. The social insurance "movement" was launched in 1906 with the establishment of the American Association for Labor Legislation, an outgrowth of the German based International Association for Labor Legislation.[1] The movement was headed by a number of Wisconsin intellectual progressives. Advanced by advocates of "social justice," "worker security," and income redistribution, social insurance remained an alien conception of German origins throughout the pre-Great Depression years. Moreover, the movement was effectively neutralized with the emergence of the old-age pension movement in the prosperous decade of the 1920's. The successful enactment of several state, old-age welfare laws during that time not only attacked the poverty problem at a decentralized level, but also limited the possibility of implementing comprehensive federal insurance programs with the dual redistribution-prevention function.

The social insurance movement, in short, was a failure in the years prior to the Great Depression. There were no bills for federal action with regard to the elderly reported out of Congressional committee and little serious committee consideration during this period. In

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[1] Ibid., p. 29.

fact, in the history of the United States, there was only one bill calling for federal welfare payments to needy aged that was reported out of committee--in 1934, five years after the onset of the Great Depression. The only bill even introduced into Congress for compulsory, old-age insurance was the Economic Security Bill, which was reported in 1935 and enacted later that year as the Social Security Act.

Summary: The Lack of Broad Demand-Side Pressure for Compulsory Old-Age Insurance

In summary, the evidence presented in this chapter clearly suggests that the origins of the old-age insurance portions of the Social Security Act lie not in pre-Great Depression years. The lack of broad demand-side pressures for compulsory, old-age insurance is evidenced by four identifiable phenomena. First, the prevalent philosophy of individualism led to a careful distinction between the problem of old-age poverty and old-age insecurity and called for different institutional responses to each. Second, the private problem of old-age insecurity was being attacked by a rapid growth and proliferation of private means of savings and insurance which began in the latter decades of the nineteenth century and continued nearly uninterrupted through 1929. Third, the problem of old-age poverty was being attacked at a decentralized level by the old-age pension movement which emerged in the 1920's to provide welfare to the needy aged at the county level. Rather than complementing the demands of social insurance advocates, the old-age pension movement threatened and eventually crippled the social insurance movement in the 1920's.

Finally, there was a clear failure on the part of social insurance advocates and other social reformers to gain any political momentum for federal, compulsory old-age insurance prior to the Great Depression.

Historical Origins of Public Relief for Old-Age Poverty

Public assistance, in its many forms, has been a part of America's institutional and legal framework since the colonial times.[1] Just like any public institution, however, its nature and form have evolved over time in response to changing conditions, both economic, political, and social as well as changing authority and control. This section traces these historical trends especially as they bear upon and help to illuminate American attitudes toward and responses to proposals for centralized, compulsory old-age insurance.

Poverty Relief: 1600-1865

Public relief, a custom since colonial days, provided a final buttress against destitution for the poor of all ages. For current purposes, what is interesting is how this mode of poverty relief evolved over time. The institutional design in the eighteenth and nineteenth

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[1] For several discussions of the origin of public poverty relief in the United States, see Walter Trattner, From Poor Laws to Welfare State : A History of Social Welfare in America (New York: The Free Press, 1974); Hace Tishler, Self-Reliance; Jonathan R. T. Hughes, The Governmental Habit: Economic Controls from Colonial Times to the Present (New York: Basic Books, Inc., 1977); pp. 44-47; and Lawrence Friedman, A History of American Law (New York: Simon and Schuster, 1973), pp. 77-78, 187-191, and 428-432.

centuries was dominated by the self-help ethic. Since the major determinants of poverty in a market economy were viewed at the time to be lack of foresight, through ignorance or idleness, public institutions were designed to discourage their use by the able-bodied and to encourage self-help. Eligibility requirements were strict, by today's standards, and the work was unpleasant. Quite often, recipients lost their right to vote along with any personal property.[1]

Many of the early developments in public relief had their origins in England.[2] When people first arrived in the New World, there was little need for public action. The population was concentrated into small communities so that those who were ill, poor, or elderly were generally cared for voluntarily by friends and neighbors within the communities. Shortly thereafter, though, as population and dependency increased, laws fashioned after the English Poor Law of 1601 emerged in the colonies to provide tax supported poverty relief. There was an acknowledgement of public responsibility to the destitute, yet administration and funding were restricted to the smallest units of government. Towns cared for the poor most frequently by placing them

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[1]Hace Tishler, Self-Reliance, p. 9.

[2]See C. G. Hanson, "Welfare Before the Welfare State," in The Long Debate on Poverty (London: Institute of Economic Affairs, 1972), pp. 113-139; and Gerald Rhodes, Public Sector Pensions, Royal Institute of Public Administration Series (London: George Allen and Unwin Ltd., 1965), pp. 29-45, for two informative discussions of the origin and development of public poverty relief in England.

in private homes, at public expense. Some outdoor relief was given to the temporarily needy, and some localities permitted auctioning dependents, as indentured servants, to the lowest bidder.[1]

Very quickly, providing for the transient poor became a problem. Transients represented not only social difficulties, but also financial difficulties. In response, the custom of "warning out" developed and was utilized through the late 1700's. In essence, a town that warned out an individual disclaimed financial responsibility for him, and placed responsibility on the town in which he had last been.[2] Other communities controlled immigration by restricting the sale of land; and eligibility, or length of residency requirements, were first established in Plymouth colony in 1671.[3]

The American Revolutionary era introduced fairly profound changes in the provision of poverty relief.[4] Principles of local control as well as voluntary provision were enhanced for a number of reasons. First, a federal system of government was established and with it, fairly strong states' rights sentiments. Second, the church-state separation led to the creation of new religious sects, and a concomitant widening of private sources of relief. In any real sense, the

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[1]Walter Trattner, From Poor Laws to Welfare State, pp. 15-23.

[2]On the custom of "warning out", see Ibid., pp. 19-20; and Lawrence Friedman, A History of American Law, pp. 77-78.

[3]Walter Trattner, From Poor Laws to Welfare State, p. 20.

[4]Ibid., pp. 29-45.

poor laws were residual to private care for the aged and needy, which had always been available through the church, the extended family, personal friendships, and fraternals. During the eighteenth century, rising wealth introduced private charity as an important complement to public welfare.

As the country expanded westward, land was abundant, labor was scarce, and the self-help, rugged-individualism ethic was fostered. In the east, however, industrialization and immigration were bringing forth rising relief expenditures and rising taxes. In fact, expenditures for poor relief were becoming the largest item in town and city budgets.[1] By the 1800's, this combination of factors led to serious attempts to distinguish between types of dependents and to make provisions accordingly. Up until this time, there had been no serious attacks on the legitimacy of the Poor Laws.

In England as well, the seeds for reform were being sewn. Mercantilism, paternalism, and government intervention, all of which had provided the climate for the Poor Law, were criticized as both morally and economically flawed. As a result of both economic and social changes during the post-Revolutionary era, the English Poor Law was reformed in 1834 to emphasize deterrence rather than alleviation. The Reform Bill set the precedent of providing relief only to those able-bodied poor who showed themselves "worthy." The conditions on relief

[1]Ibid., pp. 44-45.

were designed so that recipients found themselves worse off than the poorest self-supporting laborer, in terms of both the type of labor and the wage.[1]

The concept of the self-regulated economy, free from governmental intervention complemented American traditions of individualism, and provided, in part, the underpinnings for a trend away from outdoor relief in the United States. Outdoor relief was criticized for contributing to pauperism by leading recipients to expect relief as a right, without gratitude. Further, it was believed that compulsory tax support of public programs would eventually eliminate private charity and deprive the giver of his "Christian" right and pleasure. Finally, public relief was thought to be undesirable because of its susceptibility to political pressures for liberalized eligibility and benefits.[2]

Underlying these criticisms was the growing belief that in "the land of plenty," a great deal of the dependency problem was an individual problem. The pressure to eliminate public relief was directed toward eliminating relief of the able-bodied and those persons that

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[1]For a discussion of the Reform Bill and its implications in the United States and England, see C. G. Hanson, "Welfare Before the Welfare State," in The Long Debate on Poverty, pp. 114-116; Gerald Rhodes, Public Sector Pensions, pp. 29-32; Lawrence Friedman, A History of American Law, pp. 187-191; and Walter Trattner, From Poor Laws to Welfare State, pp. 46-55.

[2]Walter Trattner, From Poor Laws to Welfare State, pp. 46-55.

could be provided for by private charity. Public relief, restricted to indoor or institutional relief (almshouses and workhouses), was deemed appropriate for the residual group of ill, disabled, and criminal.

The Period of "Self-Reliance": 1865-1900

The Civil War marked a temporary reversal in the policy of restricting public expenditures largely to institutional relief, and for emergency reasons, large scale public relief was made available; yet for economic and social reasons, the period following the Civil War is best described as one of self-reliance.[1]

The post-Civil War period captured the early stages of rapid industrialization as well as two fairly serious economic recessions in 1870 and 1893. Between 1865 and 1900, the American economy underwent an unprecedented expansion of output and productive facilities. In 1860, there were some $1 billion invested in manufacturing plants and 1.3 million factory workers. By 1900, the amount invested had reached $12 billion, while the number of factory workers had reached 5.5 million.[2] Industrialization, rising national wealth, and a rising standard of living all contributed to an intensified influx of immigrants and rapid urbanization. Between 1860 and 1900, the proportion of the population in cities doubled, from one-sixth to one-third, and

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[1]This is the thrust of Hace Tishler's book on the origins of Social Security, Self-Reliance.

[2]Walter Trattner, From Poor Laws to Welfare State, pp. 75-76.

fourteen million persons immigrated to this country. During that same period of time, Chicago's population increased by twenty-fold, and by 1900, three-fourths of the city's population were foreign born.[1]

By 1870, the spirit of individualism had been well incorporated into the various state laws pertaining to dependency. Every state had placed legal responsibility for needy persons on the adult members of the respective families. In New York, the law specified reciprocal responsibility on adult children and their parents. In California, every member of the family--from grandparents to grandchildren, brothers to sisters--was liable for every other member's support. The laws were diverse in scope, yet the range of obligation ran between these two extremes.[2]

Public funds were distributed in the form of both indoor and outdoor relief. Outdoor relief was generally reserved for the temporarily needy and cash payments were infrequent. Instead, in-kind transfers, such as the order and payment for groceries, were utilized.[3]

The stringent conditions of, and eligibility for, public relief during the period apparently reflected an attempt by communities to institutionalize their values. Importantly, the character of public relief was guided by a distinction made between classes of

[1]Ibid., pp. 137-138.

[2]Hace Tishler, Self-Reliance, pp. 5-7.

[3]Abraham Epstein, Insecurity: A Challenge to America (New York: Harrison Smith and Robert Haas, 1933), pp. 511-513.

dependents--the poor, and paupers. A person who found himself temporarily dependent through poverty could be "grudgingly tolerated," as poverty reflected an "inability through ignorance, improvidence, or other bad habits to triumph over the economic struggle."[1] This form of dependency was a surmountable problem--temporary exposure to the conditions of public relief, just as the conditions of poverty itself, were thought to stimulate the individual to greater effort. On the other hand, paupers were the class of dependents who were both feared and disliked. They were thought to be lazy but also clever in attempting to live off of taxpayer dollars and, hence, difficult to detect. "It was the spirit of getting something for nothing that defined pauperism and set it apart from poverty."[2] As such, public relief was given in a way to discourage the latter, through undesirable conditions, and maintain the elements of shame and embarrassment to discourage the former.

As in England, work provided in almshouses was generally designed to be less desirable than work attainable outside, e.g., wood chopping or stone cutting; and similarly, the pay was set at a rate lower than attainable outside. Upon receipt of relief funds, able-bodied recipients quite often lost any personal property, the right

[1]Hace Tishler, _Self-Reliance_, pp. 8-9. See also, Lawrence Friedman, _A History of American Law_, pp. 187-191.

[2]Hace Tishler, _Self-Reliance_, pp. 8-9.

to vote, and in some cases, the right to move. Normally, attainment of eligibility required that there be no surviving legally responsible relatives.[1]

In defense of this form of public relief, one must keep in mind not only the spirit of the day, self-help, but also the ameliorating impact of the system on its own harshness.[2] There existed significant state-by-state variation as well as interjurisdiction variation in the provision of public relief. Administration was normally at the county level which made possible control by local custom and condition. Indeed, any more centralized system would have been untenable to the vast majority of Americans.

Public Relief and Private Charity

Alongside steadily increasing public expenditures, the post-Civil War period witnessed a proliferation of publc institutions (for the blind, feeble-minded, etc.) and flourishing private charity and philanthropy. In response, reformers of the period generally believed there existed a serious problem of coordinating the many relief efforts. The establishment of a Board of State Charities in Massachusetts (1863) represented the first attempt to centralize state welfare activities; and responsive to the demands of reformers throughout the North, Boards were created in several others states: New York (1867),

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[1] Ibid., p. 5.

[2] This is pointed out by Tishler; see Ibid., pp. 9-11.

Ohio (1867), Pennsylvania (1869), Rhode Island (1869), Illinois (1869), Michigan (1871), Wisconsin (1871), and Connecticut (1873). The functions of the Boards varied quite markedly from administrative control to supervisory roles. Their major function, however, was to investigate the various forms of state charities within the state and provide information on both sources of funds and potential recipients.[1]

Shortly thereafter, a parallel movement to coordinate and investigate both private and public charities developed. Along the lines of London's Charity Organization Society, the first American charity organization society was established in New York, 1877. This society, as well as the others that followed (numbering 138 by 1900), were concerned primarily with the duplicity of public and private charity. They sought to centralize and improve charity provision by "scientific" organization. These "scientific reformers" believed that the investigation of individual cases, and the maintenance of complete records, were paramount to improved efficiency.[2] In an important sense, these reformers, who attempted to centralize the supervision and control of both private and public relief monies, were beginning to carve out the profession of social work and set the stage for monopolization of this "industry."

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[1] Ibid., pp. 24-29.

[2] For a more complete discussion of the early charity organization societies in the United States, see Ibid., pp. 31-50; and Walter Trattner, From Poor Laws to Welfare State, pp. 77-93. See C. G. Hanson, "Welfare Before the Welfare State," in The Long Debate on Poverty, pp. 117-118, for a discussion of the parallel movement in England which commenced in 1869.

Despite the reformers' desire to centralize supervision and control of private and public monies, they maintained the spirit of self-help in their attitude toward the poor. They encouraged the establishment of appropriate facilities for the disabled and feebleminded and discouraged public relief to the able-bodied poor. As such, they reiterated a general feeling that the able-bodied should be released to private charity where they could be carefully screened and subject to undesirable work. Again, a means of separating the worthy from the unworthy was sought for which the work test became the primary instrument. All measures were designed so as not to breed pauperism among the poor.

A number of factors supported the "scientific reformers" in their move to eliminate public outdoor relief and organize private charity. First, the depression of 1870 brought attention to the lack of coordination and welfare activities. In a country with abundant private charity, supplemented by public relief, there existed an inability to mobilize resources in an emergency. Bread lines formed, and lodging was made available, yet rioting reached the point that many states had to send in militias.[1] Second, political graft and corruption was not unknown. Reformers and individualists alike questioned the efficiency and honesty of public relief systems. According to the Mayor of Brooklyn during the 1870's,

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[1] Walter Trattner, From Poor Laws to Welfare State, p. 83.

> The general demoralization which set in after the war placed a corrupt man in charge of the poor funds . . . first preference went to families with voters and particularly those who were known to be friends with politicians.[1]

Civil War pensions provided yet another example of the difficulties of public relief provision. In one year alone, during the 1880's, liberalized and retroactive eligibility requirements were instituted which doubled federal pension expenditures the following year. Within the next decade, expenditures tripled and the number of recipients doubled.[2]

Finally, as the economy prospered subsequent to the Civil War, Social Darwinism became the "prevailing philosophy of the era." An economic system consistent with this philosophy was one that permitted the "survival of the fittest," with a government that confined its activities to insuring individual liberty through the protection of private property rights. As far as providing for the poor and elderly, private and voluntary means were deemed appropriate.[3]

Some doubted how scientific the methods of the reformers actually were as the "scientific approach often required little more than an intelligent exchange of opinion or led to more than an

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[1]Cited by Hace Tishler, Self-Reliance, p. 32.

[2]Ibid., p. 19.

[3]See Walter Trattner, From Poor Laws to Welfare State, pp. 81-84. William Graham Sumner was an outspoken proponent of this philosophy. See, in particular, William Graham Sumner, What Social Classes Owe to Each Other (Caldwell, Idaho: The Caston Printers, 1974).

exercise in classifying data."[1] It is important to note, however, that these reformers, who emphasized supervision, investigation, and case work were creating a new field of professional social work. By 1900 in fact, the volunteer workers who had formed the core of charity workers and "scientific reformers" were being replaced by paid professional caseworkers.[2]

In contrast to the scientific charity movement which stressed the importance of the middle class virtues of work and thrift, there emerged a settlement house movement in the late 1880's. Residents of settlement houses, located in large urban areas, were "social reformers" who hoped to learn the problems of the poor by first hand experience in order to effect improvements in urban life. These persons, who were for the most part young, well-to-do, college graduates, rejected the notion that poverty was an individual problem and believed that economic and social conditions beyond the individual's control were to blame.[3]

By the turn of the century, charity workers and social reformers joined forces in stressing the need for professional education for social workers and in believing that poverty was largely beyond the control of the individual. It was at this time that reformers

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[1] Hace Tishler, Self-Reliance, pp. 28-29.

[2] Walter Trattner, From Poor Laws to Welfare State, pp. 92-93.

[3] Ibid., pp. 136-150.

and progressives began to advocate policies for "social justice": preventive legislation (minimum wage laws, child labor laws, etc.), and social insurance.[1]

In summary, throughout the 1800's, public relief was dominated effectively by private charity and private provision for the elderly. The post-Civil War period witnessed a flourishing of private charity and philanthropy, along with an important evolution in the meaning of individualism for the issue of old-age dependency and insecurity. For alleviation of poverty, the family and church remained important means of financial protection in old-age. The key to attacking the problem of financial insecurity was still viewed, during this period, as being one of prevention rather than relief. It is interesting to note that there were two fairly serious recessions during the period of "self-reliance" and in neither case was there an articulated demand for federalized, compulsory provision of "security." Instead, there was a growing tendency to rely on the private sector. The recession of 1870 brought attention to the need to coordinate the many forms of private charity and public relief with emphasis on reducing the role of indiscriminate relief to the able-bodied poor. The institutional response to a second deep recession in 1893 was the rapid growth and proliferation of private schemes to ensure old-age financial security.

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[1]Ibid., pp. 150-152.

Historical Development of Private Provision for Old-Age Financial Insecurity

With prevention viewed as the key to attacking the problem of financial insecurity, it is significant that the earlier means of prevention were developing rapidly and new means were emerging during this period. Individual thrift and saving were still fundamental, but new voluntary cooperative means--various forms of group insurance--emerged to reduce the individual burden, though not the responsibility. The most important developments were in mutual benefit associations, industrial insurance, and fraternal societies.

Mutual Benefit Associations, Industrial Insurance, and Fraternal Societies: 1850-1900

Mutual benefit associations, organized along religious and ethnic lines, were among the first institutions set up by and for minorities.[1] As such, they served a significant role in the last decades of the nineteenth century. Rates of immigration were reaching all time highs and alternative forms of relief were frequently not available due to residency requirements of up to twenty-five years. These associations were similar to fraternals in being social organizations providing benefits to members. What distinguished mutual benefit associations was that fixed premiums were not normally established against

[1] Hace Tishler, *Self-Reliance*, pp. 22-23.

future contingencies. Instead, assessments were made at the time of loss, or benefit payment, in amounts sufficient to liquidate the particular loss.

Industrial insurance was a new development of the period as earlier development had been hampered by a general feeling that insurance was a form of gambling. Not only did an early death reduce the rate of return, but also for the number of plans without actuarially sound funds, accurate mortality tables, etc., it was indeed a gamble whether or not benefits would be received in the distant future. In time, of course, experience and the process of competition would have eroded these problems. Fraternals and mutual benefit associations largely escaped this problem as the bond of friendship and local-member control made the investments more secure.

For those wage-earners without the friendly society option, industrial pensions (or retirement insurance) and life insurance provided a viable, low cost means of saving. Premiums were paid weekly since industrial insurance was designed primarily for hourly wage-earners for whom annual or semi-annual premiums would have been prohibitively costly. In 1876, there was only one industrial insurance plan with less than 5,000 policies in force, the combined face value of which was less than $500,000. In that year alone, 7,000 additional policies were issued, "foreshadowing the spectacular growth to come."[1]

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[1] Ibid., p. 23. See also Charles R. Henderson, Industrial Insurance in the United States (Chicago, 1908).

By 1892, there were more than 5 million insurance policies in force, and eleven companies with industrial pension plans.[1]

On a smaller scale, establishment funds enjoyed a comparable expansion. These plans were normally formed along occupational lines to provide benefits to workers within a given company or plant. By 1890, there were 126 establishment funds of which 100 were created in the previous decade, 21 created between 1871-1880, and 5 created prior to 1871.[2]

In the period being considered, fraternal societies, the oldest means of insurance in America, provided the dominant source of coverage. Fraternals embodied the American tradition of individualism in its emerging form--voluntary association. The origins of the fraternal society date to the Old Roman Empire, and by medieval times, there existed similar commercial and social guilds throught Western Europe.[3]

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[1]Ibid., p. 23.

[2]Hace Tishler, Self-Reliance, p. 23. See also Boris Emmet, "The Operation of Establishment and Trade-Union Funds," Monthly Labor Review, V (August, 1917):217-252.

[3]For an interesting history of fraternal societies, see Walter Nichols, "Fraternal Insurance in the United States: Its Origin, Development, Character, and Existing Status," Annals of the American Academy of Political and Social Science, LXX (March, 1917): 109-122. See also, Abb Landis, "Life Insurance by Fraternal Orders," Annals of the American Academy of Political and Social Science, XXIV (July-December, 1904):475-488; Roy Lubove, The Struggle for Social Security, pp. 19-22; and Hace Tishler, Self-Reliance, p. 23. For a discussion of their English counterparts, see C. G. Hanson, "Welfare Before the Welfare State," in The Long Debate on Poverty, pp. 118-127; and Gerald Rhodes, Public Sector Pensions, pp. 30-45.

By the nineteenth century, the tradition was most clearly evidenced in England and the United States. Unlike English fraternals which placed emphasis on their social function, American fraternals placed more emphasis on their insurance function.[1] In England, insurance benefits were restricted mainly to sickness and funeral, whereas American societies operated more or less as mutual life insurance companies. In both countries, sickness insurance was broadly defined to cover all types of incapacity including old-age.

Fraternals, designed for the mutual aid of their members, were attractive means of organization for a number of reasons. Not only did they maintain the personality of clubs through the local lodge system, but also they were at a cost advantage in providing insurance. The lodge system permitted a significant reduction in the costs associated with field work and administration. Since lodge members were voluntary solicitors, there were no middlemen. It was estimated in 1904, that the management costs for private companies were approximately \$8-\$9 per \$1,000 worth of insurance in force compared to fraternals whose costs were less than \$1 per \$1,000 worth of insurance in force.[2]

It is not surprising that the rapid growth in fraternal insurance after 1860 was met by sharp attack by private insurance

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[1]Walter Nichols, "Fraternal Insurance in the United States," Annals of American Academy of Political and Social Science, pp. 109-110.

[2]Abb Landis, "Life Insurance by Fraternal Orders," Annals of American Academy of Political and Social Science, p. 482.

companies that were already subject to legal restrictions on solvency and management. These attacks culminated in the first legislation in 1888 which placed restrictions on the ratio of assets to liabilities and required fraternal rate hikes necessary to build up adequate funds. By the early twentieth century, thirteen states had complied with the Mobile Bill.[1]

Government regulation of what was considered to be a purely private matter--providing for oneself and one's family--ran counter to the most fundamental principles in the period of individualism. This is reflected below in a statement made in response to the threat of government intervention in 1904:

> The members [of fraternals] are neither children nor imbeciles, and do not need the fatherly care of insurance commissioners or state legislators . . . Unfortunately, the paternalistic tendency which is becoming more and more apparent in both state and federal governments, has so affected the various commissioners of insurance that they are not content to leave well enough alone, but must break the egg to let the chicken out.[2]

Nonetheless, fraternals continued to enjoy rapid growth and by 1893, insurance policies were held by nearly 3.7 million members.[3] In 1896, more than $28 million were paid out in benefits.[4]

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[1]Walter Nichols, "Fraternal Insurance in the United States," Annals of American Academy of Political and Social Science, pp. 113-116.

[2]Abb Landis, "Life Insurance by Fraternal Orders," Annals of American Academy of Political and Social Science, p. 485.

[3]Hace Thisler, Self-Reliance, p. 23.

[4]Walter Nichols, "Fraternal Insurance in the United States," Annals of American Academy of Political and Social Science, pp. 119-120.

The last decade of the nineteenth century, generally "regarded as one of the economically most troubled periods in our history," warrants particular attention as it marked a spurt of growth in, and reliance on, private institutions for the provision of financial security in old-age.[1] After the stock market collapsed in 1893, huge currency withdrawals lead to the failure and suspension of both private and national banks. Restrictions on cash payments were not ended until September of that year, and deflation prevailed for the next three years. Unemployment reached 18.4 percent in 1894 and averaged over 14 percent from 1893-1898.[2]

The institutional response to heightened financial insecurity, however, was a growing and continued reliance on the private sector. It is important to note that rather than changing basic attitudes toward individual thrift and responsibility, the economic climate simply made financial foresight more urgent. For example, industrial insurance prospered during the 1890's. Between 1892 and 1900, the number of policies in force more than doubled, rising from 5,000,000 to 11,000,000. Like commercial insurance companies, fraternal insurance experienced uninterrupted growth. By 1900, there were 600 fraternal insurance societies, 60 percent of which emerged in the previous decade. Membership climbed from 3.7 million to 5.3 million, and coverage was

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[1] Quoted material by Milton Friedman and Anna Schwartz, A Monetary History of the United States, p. 97.

[2] Ibid., pp. 104-113.

estimated at $6 billion. In addition, the number of establishment funds doubled during the ten year period. Finally, within the eighty national unions existing in 1900, as many insurance plans were initiated between 1892-1902 as had been in the previous thirty years.[1]

Growth of Private Savings and Pension Plans: 1900-1928

The years between 1900-1928 were economically disrupted. The period opened with a continuation of the vigorous expansion in population, immigration, and industrialization that had started in the last two decades of the nineteenth century; yet in 1907, the first of a series of recessions took place. It was followed by World War I's intensification of an ongoing recession, coupled with another severe contraction in 1920. It was not until the 1920's that the American economy experienced nearly a decade of stability and prosperity. Only two mild recessions occurred, and "soaring optimism" characterized the decade.[2] The period culminated with the stock market collapse of October, 1929, and the commencement of the Great Depression.

The unsettled economic and political climate fostered significant developments for private provision for financial security along several different lines. In particular, throughout this period, there was continued growth of, and reliance on, private institutions for

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[1]Hace Tishler, Self-Reliance, pp. 69-75.

[2]Milton Friedman and Anna Schwarts, A Monetary History of the United States, p. 296.

old-age financial security. In general, the economy was prospering--real income and real wages were rising--and the evidence on savings and insurance indicate that the important trends which started in the late nineteenth century were continued into the twentieth century, pre-Depression period.

Table 1 indicates the remarkable early progress in at least one type of savings, savings bank deposits. As indicated in the table, between 1880 and 1915, real per capita deposits increased by as much as 193 percent. Between 1912-1925, the average savings deposit (all banks) increased 28 percent even taking into account an 80 percent increase in prices, and a 20 percent increase in population. In the first five years of the 1920's alone, the real average savings deposit (all banks) increased 67 percent.

The rapid acceptance of alternative private means of saving is reflected in Table 2. United States postal savings deposits were introduced in 1911, and in the following four years, total deposits increased 43 percent (both measured in real terms).

For a broader view of trends in savings over the period 1910-1928, Table 3 presents real annual increments for various measures of savings. In each period, savings deposits of various kinds showed increasing net additions. The severe recession of 1920, is reflected in a reduction in the rate of growth of total personal savings after 1919.

TABLE 1

REAL SAVINGS BANK DEPOSITS: 1880-1915
[1975 Dollars]

June 30	Number of Depositors	Amount on Deposit (Billions of Dollars)	Average Dep. Per Capita
1880	2,335,585	$ 4.5	$ 90.72
1890	4,258,893	9.1	145.80
1900	6,107,083	15.8	205.00
1910	9,142,908	23.4	259.91
1915	11,285,755	26.4	264.07

SOURCE: Frederick L. Hoffman, Facts and Fallacies of Compulsory Health Insurance, p. 80.

TABLE 2

UNITED STATES POSTAL SAVINGS: 1912-1915
[1975 Dollars]

Year	Number of Depositors	Amount on Deposit	Average Deposit
1912	243,801	$112,428,250	$461.17
1913	331,006	183,798,210	555.27
1914	388,511	232,322,310	597.97
1915	525,414	347,538,140	661.48

SOURCE: Frederick L. Hoffman, <u>Facts and Fallacies of Compulsory Health Insurance</u>, p. 81.

TABLE 3

REAL ANNUAL INCREMENTS IN VARIOUS MEASURES OF SAVINGS: 1910-1928[a] [In Millions of Dollars]

Period	Savings Bank Deposits	Time Deposits	S & L Assns.	Total Personal Saving
1910-1914	$ 924	$2,286	$ 434	$16,467
1915-1919	1,053	4,721	488	34,036
1920-1924	1,298	4,628	1,205	20,013
1925-1928	1,745	4,976	2,054	28,430

SOURCE: U.S. Bureau of Census, Statistical History of the United States, p. 266; and Earl Muntz, Growth and Trends in Social Security, No. 5 (Washington, D.C.: NICB, Inc., 1948), p. 20.

[a]1975 Dollars.

Of particular interest with regard to retirement pensions is the development of industrial pension plans during the early twentieth century. Industrial insurance was popular because it was within the reach of low wage-earners. Premiums were small, say 1 percent of wages, and monthly pensions averaged $40-50 ($124-155) in 1927.[1] Table 4 indicates the rapid growth of these plans from 1874-1929.

By 1929, industrial pension plans covered 4 million workers or two-thirds of all the persons covered by major public and private pension plans.[2] The principle pension plans are summarized in Table 5 by coverage and number of beneficiaries. Excluding fraternal membership, nearly 6.4 milion persons, or 14 percent of the labor force, were covered by these major pension plans.

The observed progress in the private sector was a natural outgrowth of rising incomes in conjunction with the individualistic values of savings and thrift, and provided evidence to many that compulsory old-age insurance was a needless invasion in the private sector. As one social insurance opponent said,

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[1] "Industrial Old-Age Pension Plans," Bulletin of the U.S. Bureau of Labor Statistics, No. 439 (June, 1927), p. 438. All dollar figures in parentheses are calculated on the basis of 1975 prices.

[2] National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, Inc., 1931), p. 24.

TABLE 4

GROWTH OF INDUSTRIAL PENSION SYSTEMS PRIOR TO THE GREAT DEPRESSION

Year Plans Established	# of Plans Established Per Year	Cumulative # of Plans
1874-1900	.43	12
1901-1905	4.80	36
1906-1910	6.00	66
1911-1915	20.40	168
1916-1920	27.00	303
1921-1925	15.40	380
1926-6/30/1929	17.14	440

SOURCE: Murrey W. Latimer, Industrial Pension Systems (2 vols.; New York: Industrial Relations Counselors, Inc., 1933), II, p. 843.

TABLE 5

PENSION SYSTEMS IN THE UNITED STATES: 1928

Classes	Number Covered	Number of Beneficiaries
Government Employees		
a. Federal executive civil service. . .	568,715	14,119
b. State employees.	34,500[a]	1,397
c. Municipal employees.	93,374[b]	4,619
Teachers		
a. State.	371,835	13,094
b. City	54,776	3,949
c. Carnegie Fund, including teachers' widows	---	922
Policemen and firemen.	67,765	20,327
U.S. war pensioners.	---	491,194
Industrial pensions, including railroads .	4,000,000	80,000
Trade union benefits		
a. Pensions	640,000	11,509
b. Disability for old age	352,000	---
c. Superannuation benefits.	143,000	---
Y.M.C.A. secretaries	3,676	247
Y.W.C.A. secretaries	1,031	65
Ministers.	---	28,319

SOURCE: National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, 1931), p. 25.

[a]Figures for Conn., Mass., N.J., and N.Y. Maine and Pennsylvania also granted pensions to state employees.

[b]Figures for Baltimore, Boston, Chicago, Detroit, Minneapolis, New York City, Pittsburg, and San Francisco. Philadelphia also had a municipal employee pension system, but figures not available.

> It may be safely asserted that where so much has been achieved within so comparatively short a period of time, even more impressive results will be secured in the future in conformity with the everbroadening principles of voluntary thrift and without the unworthy necessity of coercion or compulsion, as the case may be.[1]

Of course, one cannot conclude on the basis of this evidence that poverty amongst the elderly was not an important and ever growing problem. A rising proportion of elderly persons, industrialization, urbanization, and immigration in the early 1900's all contributed to elevating old-age poverty to a leading social issue in the 1920's.[2] By that time, poverty relief had evolved from a strictly local concern to a matter of widespread state concern.

The Emergence of State Old-Age Pension Laws: 1900-1929

The Question of Old-Age Pensions Examined

The first state commission in the United States set up to study the issue of old-age dependency was established in 1907. The Massachusetts Commission on Old-Age Pensions represented the first public endeavor to examine and consider the advisability of state old-age pension legislation and "marked the first significant entry of the

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[1] Frederick Hoffman, Facts and Fallacies of Compulsory Health Insurance (Newark: Prudential Life Insurance Co., 1917), pp. 80-83.

[2] See, for example, American Association for Old-Age Security, Bulletin of the American Association for Old-Age Security, Vols. I-V (1927-1931).

aged into American social politics."[1] Note that as of this time there was still no serious consideration of either national pension provision or compulsory insurance legislation. The ensuing pension movement was simply a movement for poverty relief for the elderly to be financed from general funds. The Commission found the extent of old-age dependency insufficient to warrant state action and feared that state intervention would weaken family solidarity, the final buttress to old-age dependency.[2]

About the same time, apparently the first piece of federal pension legislation was introduced into Congress by Congressman William Wilson of Pennsylvania, who later became the Secretary of Labor. Fearing that legislation to provide pensions for non-military persons would be found unconstitutional, he proposed establishing an Old Age Home Guard, a pseudo-military corps, within the United States Army. The elderly would have been enlisted into the Guard to report annually on patriotic sentiments in their communities, and then be eligible as military personnel for federal pensions. It is of little surprise that the bill died in committee.[3]

In 1910, a second Massachusetts Commission was appointed to study old-age dependency. Out of the 177,000 elderly persons in

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[1]Roy Lubove, The Struggle for Social Security, pp. 118-119.

[2]Ibid.

[3]Abraham Epstein, Insecurity: A Challenge to America, p. 532; and The Challenge of the Aged, pp. 260-261.

Massachusetts, the Commission estimated that nearly 80 percent were self-supporting. Of the dependent aged, only 8 percent resided in almshouses. As such, conditions did not warrant a state pension scheme for three reasons. A state plan would: (1) tend to depress wages; (2) attract pension-seekers from other states; and most importantly, (3) would weaken family solidarity.[1]

In the 1910 report, the Commission distinguished between non-contributory (i.e., general revenue supported) and contributory pensions. Concerning non-contributory old-age pensions, the Commission reported, "If such a scheme be defensible or excusable then the whole economic and social system is a failure. The adoption of such a policy would be a confession of its breakown."[2] On contributory pensions, the Commission was still negative, but qualifiedly so. They were "unthinkable and distasteful," to Americans, but conceivable as "enforcement upon the individual of the obligation of self-support."[3] The Commission concluded,

> It is of striking interest that, at a time when European governments are instituting systems of state insurance and pensions . . . the American railroad and industrial corporations are attempting to solve this problem on their own initiative, through private systems supported by the revenues of the pensioning company.[4]

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[1] Roy Lubove, The Struggle for Social Security, p. 118.

[2] Cited by Hace Tishler in Self-Reliance, p. 88.

[3] Ibid.

[4] Ibid.

In 1911, another federal pension bill was introduced into Congress by Victor Berger of Wisconsin, the first Socialist representative. The plan was designed to provide pensions up to $4 ($23) a week to all persons over the age of sixty who had weekly incomes less than $10 ($57). This bill died in committee, as did every other bill introducing federal pensions through the 1920's.[1]

Old-age pension legislation did not emerge prior to the 1920's for a number of reasons, all centering around the fact that there simply existed a lack of popular support. The issues raised in opposition to state old-age pension legislation overlapped with those raised earlier in response to the social insurance movement and with those that were raised again preceding the enactment of the Social Security Program.[2]

The end of the Progressive Era was marked with fairly intense nationalism. Not only did this create an inhospitable environment for the development of social insurance, the "alien import," but it also created an inhospitable environment for the extension of relief to the general public.[3] Immigration had reached all time highs near the turn

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[1]Abraham Epstein, Insecurity: A Challenge to America, p. 532.

[2]For discussions of the major arguments for and against state old-age pensions, see National Industrial Conference Board, The Support of the Aged, pp. 61-65; "Old-Age Pensions and Relief," Bulletin of the U.S. Bureau of Labor Statistics, No. 491 (August, 1929), pp. 529-533; and "Old-Age Pensions and Relief," Bulletin of the U.S. Bureau of Labor Statistics, No. 439 (June, 1927), pp. 431-454.

[3]Hace Tishler, Self-Reliance, p. 93.

of the century and, by 1930, it was estimated that nearly 30 percent of the aged in the United States were foreign born.[1] Importantly, there were nearly three times as many foreign born in almshouses as native Americans.[2] Accordingly, many critics of public relief opposed the extension of general taxpayer money for the relief of immigrants.

No less important than the animosity toward subsidizing the foreign born, was a general unwillingness to subsidize minority groups. States with concentrations of Blacks, Mexicans, and Indians were particularly slow to initiate old-age pension legislation. In 1934, of the twenty states which did not yet have old-age pension laws, thirteen were in the South.[3] Finally, critics opposed government insurance and pensions on the grounds they were paternalistic programs devised by Germany's Iron Chancellor.[4]

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[1] National Industrial Conference Board, The Support of the Aged, p. 41.

[2] Ibid.

[3] Paul Douglas, Social Security in the United States, p. 9.

[4] See for example, Frederick L. Hoffman, "Autocracy and Paternalism vs. Democracy and Liberty" (Address before the International Association of Casualty and Surety Underwriters, New York, December 14, 1914); and P. Techumseh Sherman, "Dangerous Tendencies in the American Social Insurance Movement," Address before the Insurance Society of New York, November 21, 1916 (New York: Insurance Society of New York, 1917).

Less ideological barriers to the extension of old-age pension legislation were also important: the constitutionality and the cost.[1] As the pension movement got underway, several states were encumbered by serious constitutional questions. It was not uncommon that state legislatures were constitutionally prohibited from appropriating money for educational, benevolent, or charitable purposes. Further, even if money could be appropriated, many states feared the ultimate cost to the taxpayer. Public welfare schemes implemented at the local or state level had to be carefully designed so as not to be so generous as to attract outsiders. States that did implement programs in the 1920's frequently specified state residency requirements of up to twenty-five to thirty years in an effort to avoid this problem. Other states simply were not willing to undertake such action without federal assistance.

Finally, attention was only beginning to be focused on the elderly. As mentioned earlier, the Massachusetts Commission on

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[1] Table 9 reveals the constitutional obstacles to the old-age pension movement. In England, Alfred Marshall had opposed state pension schemes, saying "My objections to them are that their educational effect, though a true one, would be indirect; that they would be expensive; and that they do not contain, in themselves, the seeds of their own disappearance. I am afraid that, if started, they would tend to become perpetual. I regard all this problem of poverty as a mere passing evil in the progress of man upwards; and I should not like any institution started which did not contain in itself the causes which would make it shrivel up, as the causes of poverty itself shrivelled up." Official Papers by Alfred Marhsall, ed. J. M. Keynes (London, 1926), p. 244, cited in F. A. Hayek, The Constitution of Liberty, p. 509.

Old-Age Pensions led the movement and, although it reported unfavorably on the issue of pension legislation, it represented the first of a series of state studies on the degree of old-age dependency. By the 1920's, provision for the elderly poor had become the leading social issue.[1]

The Material Status of the Elderly

Important economic and demographic changes had taken place during the late nineteenth and early twentieth centuries that affected the material status of the aged and contributed to a reevaluation of the needs of the elderly poor. First of all, on the demand side, the elderly simply represented a rising proportion of the total population. In 1850, only 2.1 percent of the population was over sixty-five. As indicated in Table 6, by 1900, this proportion had risen to 4.1 percent and in 1920, the elderly accounted for 5.4 percent of the total population. The rate of increase in the proportion of elderly was greater in each decade between 1900 and 1930 than the rate of increase for the entire population. Medical advances were the major contributor to the weighting of the age distribution toward the elderly. Between 1900 and 1929, alone, life expectancy at birth had increased from 47.88 years for males and 50.70 for females, to 57.1 years for males and 60.99 for females.[2]

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[1]See for example, "Old-Age Security Leading National Issue," _Bulletin of the American Association for Old-Age Security_, Vol. III, No. 3 (March, 1929), p. 1.

[2]Roy Lubove, _The Struggle for Social Security_, p. 114.

TABLE 6

NUMBER OF PERSONS AGED 65 AND OVER COMPARED TO TOTAL POPULATION 1890-1930

Year	Number Aged 65 and Over	Total Population	Percent Aged 65 and Over
1890	2,424,000	62,622,000	3.9
1900	3,089,000	75,995,000	4.1
1910	3,958,000	91,972,000	4.3
1920	4,940,000	105,711,000	4.7
1930	6,634,000	122,775,000	5.4

SOURCE: U.S. Bureau of Census, The Statistical History of the United States: From Colonial Times to Present (New York: Basic Books, Inc., 1976), p. 15.

As Tables 7 and 8 indicate, between 1900-1930, the proportion of workers in farm related occupations had decreased by 48 percent while the urban population had increased by 40 percent. No longer were the majority of families residing and earning their incomes on farms. They became more mobile, and in many cases, their livelihoods became more closely tied to wage income.

These trends had a number of implications for the status of the elderly. Increased worker mobility jeopardized the extended family as it became more costly to support elderly family members when they resided away from the home. Further, the combination of longer life spans and earlier retirement in industrial jobs increased the number of retirement years the worker's accumulated savings had to support. Many persons could no longer rely on continued employment on the farm in old-age, and industrial jobs, quite often by the nature of their pension plans, enforced early retirement rules.

One must take care in interpreting the effect of industrialization on old-age security; for indeed, both rising real incomes and increased saving, associated with the period of industrialization, placed the individual in a better position to provide for his financial future. Further, not all early retirement was involuntary and not all retirement uncompensated. Rising incomes and the availability of old-age pensions encouraged voluntary retirement at an earlier age.

While the impact of economic and demographic changes undeniably affected the extent of old-age poverty, there is little reliable data

TABLE 7

PROPORTION OF GAINFUL WORKERS IN FARM-RELATED OCCUPATIONS

Date	%
1860	59%
1880	49%
1900	38%
1920	27%
1930	21%

SOURCE: U.S. Bureau of Census, 15th Census of the Population (1930).

TABLE 8

PROPORTION OF TOTAL POPULATION
IN URBAN AREAS

Date	%
1880	28.6%
1900	40.0%
1920	51.4%
1930	56.2%

SOURCE: U.S. Bureau of Census, The Statistical History of the United States: From Colonial Times to the Present (New York: Basic Books, Inc., 1976), p. 11.

on the extent of old-age proverty during the 1920's and 1930's. "Dependency" figures were neither reliable nor did they reveal the extent of poverty. One study revealed that 18-40 percent of the country's elderly were dependent on the family, private and public charity.[1] One conjectured that 40 percent was the most reliable estimate.[2] Another study of elderly persons in eastern states found that 33 percent had no source of income and 38 percent had property valued at less than $1,000.[3] But, what do these figure convey? In some studies a person with a steady income, living with his family and owning no valuable property, was labelled dependent. In other studies a person without an income, who lived comfortably off his accumulated savings, was also labelled dependent. It was simply erroneous to count as dependent all those persons who lived with and depended upon their families or church. These persons may have contributed to the support of their children, or the church, under the implicit agreement that they would be cared for in old-age. Such an indiscriminate count of elderly parents who were cared for in the home of their children may have revealed little more about poverty than would have a count of children who were supported in the home of their parents.

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[1] Study by A. M. Edwards, cited by Abraham Epstein, Insecurity: A Challenge to America, p. 498.

[2] Ibid.

[3] Ibid., pp. 498-500. See also, Isaac Rubinow, The Quest for Security, p. 234.

Two examples will illustrate the problems in interpreting dependency figures. A study in 1935, acknowledged by the Supreme Court, found that three-quarters of the elderly population were dependent on others for support. It was later revealed that these computations assumed explicitly that all property held by an elderly married couple was owned by the husband so that every elderly wife was counted as dependent.[1] Another study found that the percentage of elderly persons residing in almshouses increased dramatically from 25.6 percent in 1880, to 53.8 percent in 1923.[2] The study ignored the impact of elderly population increases, and more important, the trend toward removing the physically handicapped, criminal, and juvenile to special institutions.[3]

In summary, it is safe to conclude that the extent of old-age poverty was increased by industrialization and urbanization through their impacts on family solidarity and employment security. It is difficult, however, to assess the extent of old-age poverty; particularly so, as most studies undertaken during this period were conducted by social insurance advocates, those who had vested interests in overstating dependency.

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[1]F. A. Hayek, The Constitution of Liberty, pp. 296-297.

[2]Abraham Epstein, Insecurity, p. 501.

[3]National Industrial Conference Board, The Support of the Aged, p. 37.

Fraternal Support for State Action

As important as any of the above cited economic and demographic factors accounting for the growing interest in the elderly poor and their care was the role played by the Fraternal Order of Eagles (FOE). In mid-1921, the Indiana State Aerie of the FOE adopted a resolution supporting state pension legislation. Within the year, under the leadership of Frank Hering, the "Past Grand Worthy President," the Grand Aerie formally endorsed government action and established an Old-Age Pension Commission.[1] The significance of this development should not be underestimated as fraternals had helped to form a backbone of opposition to government action in the field of old-age insecurity. Importantly, the FOE supported relief to the needy aged but not compulsory insurance. Fraternals remained adamantly opposed to a government monopolization of old-age insurance.

In 1922, the Eagles joined with the American Association for Labor Legislation (AALL) in preparing a Standard Bill that served as the model for several early state old-age pension laws. In addition, they mustered the cooperation and support of various state labor federations as well as the National Old-Age Pension Committee of the United Mine Workers. The Eagles endorsement of old-age pension legislation and their cooperation with organized labor represented a significant

[1] Roy Lubove, The Struggle for Social Security, pp. 137-143.

addition to the strength of the pension movement. Publicity and legislative campaigns hastened the process of familiarizing the public with issues that had heretofore been argued by intellectuals.[1]

Abraham Epstein, who was hired in 1922 as Hering's research director, led the Eagles' campaign and later became one of the foremost proponents of social insurance during the Depression. Born in Russia, Epstein emigrated to the United States in 1910, studied economics, and became an avid colleague of Isaac Rubinow, an early and important social insurance advocate. While an outspoken figure in the Eagles' movement, Epstein was also appointed as research director of the Pennsylvania Commission on Old-Age Pensions, which had been established in 1917. He devoted years trying unsuccessfully to get pension legislation passed in Pennsylvania.[2]

The opposition met by Epstein and the pension movement in Pennsylvania was not unrepresentative of the opposition expressed in other states. Two outspoken opponents were the State Chamber of Commerce and the Manufacturers' Association. In response to efforts to institute a constitutional amendment required for pension legislation, the Chamber of Commerce remarked that pensions were an "insidious experiment in paternalistic government which would sap self-respect and destroy moral fiber of thousands of people, besides costing the taxpayer millions of dollars."[3]

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[1]Roy Lubove, The Struggle for Social Security, pp. 137-143.

[2]Ibid., pp. 138-140.

[3]Ibid., pp. 139-140.

The strong opposition of well organized business interests in Pennsylvania dampened the credibility of the Eagles and Epstein throughout the country.

Despite the growing attention accorded the elderly, and the efforts of the AALL and the Eagles, only a few pieces of state pension legislation emerged during the twenties. The lack of broad political support was evidenced by the almost complete waning of interest in social insurance during this prosperous decade. Also, internal disputes within the ranks of pension and insurance advocates weakened their effectiveness.

State Action: 1920-1928

Prior to the Depression, the issue of state old-age pensions had been debated in most states, but laws had been enacted in only six: Nevada, Montana, Wisconsin, Kentucky, Maryland, and Colorado. Most proposed legislation met open opposition. Laws were vetoed, found unconstitutional, and amended; pending legislation was delayed.[1]

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[1]For additional sources on the emergence and operation of state old-age pensions, see "Efforts Seeking Federal Pensions," The Congressional Digest, Vol. XIV, No. 3 (March, 1935), pp. 72-73; Paul Douglas, Social Security in the United States, pp. 5-10; Abraham Epstein, Insecurity, pp. 532-550; National Industrial Conference Board, The Support of the Aged, pp. 44-65; "Old-Age Pensions and Relief," Bulletin of the U.S. Bureau of Labor Statistics, No. 491 (August, 1929), pp. 529-533; and "Old-Age Pensions and Relief," Bulletin of the U.S. Bureau of Labor Statistics, No. 439 (June, 1927), pp. 431-454.

The precedent for public old-age pensions was the enactment of the Sterling-Lehlbach Act of 1920. The Act established a retirement system for federal civil service employees, then numbering 300,000. Numerous municipal plans were already in existence by this time

As discussed in Chapter III, during the Depression years alone (1929-1933), though, old-age pension laws were enacted in twenty-one states and Hawaii. Whereas most of the laws that preceded the Depression were county optional and effectively inoperative, those enacted after the onset of the Depression were primarily state-wide and mandatory. Table 9, a description of the actions taken on state old-age pensions prior to the Depression, reveals the constitutional and legislative problems inherent to the movement.

For the early laws enacted, "state" old-age pension legislation was a misleading term. The first laws were not mandatory, nor were they state-wide; instead, they were county optional. As such, the state determined maximum monthly pensions payable and broad conditions on eligibility, but funding and administration were county controlled.[1] By the time of the onset of the Great Depression, however, the majority of plans were state-wide and mandatory. In these instances, the counties were compelled to provide pensions to the eligible aged, but frequently continued to provide their own source of

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covering, notably, teachers, firemen and policemen. See Roy Lubove, The Struggle for Social Security, p. 126; "The Cost of Existing Retirement Systems," The Congressional Digest, Vol. XIV, No. 3 (March, 1935), p. 73; and "Public Service Retirement Systems in the United States," Bulletin of the U.S. Bureau of Labor Statistics, No. 491 (August, 1929), pp. 542-547.

[1]National Industrial Conference Board, The Support of the Aged, pp. 46-48.

TABLE 9

STATE ACTION ON OLD-AGE PENSION LAWS

1915: Alaska enacted the first old-age pension law.

Arizona passed a law abolishing almshouses and establishing old-age pensions. The law was shortly thereafter declared unconstitutional.

1923: Old-age pension laws were passed in Nevada, Montana and Pennsylvania.

The residents of Ohio defeated by referendum vote of 2 to 1, a proposal to institute old-age pensions.

1924: The Pennsylvania pension law of 1923 was found unconstitutional.

1925: In Wisconsin, an old-age pension law was passed. In California, a pension law was passed by the state legislature, but the Governor vetoed it.

The Nevada law of 1923 was repealed, modified, then reenacted.

Efforts to repeal the Montana law of 1923 were unsuccessful.

1926: An old-age pension law was enacted in Kentucky. The Governor of Washington, however, vetoed a recently enacted pension law.

1927: Old-age pension laws were passed in Maryland and Colorado.

1928: Massachusetts passed a "public bequest" law which included provisions for the elderly poor.

1929: Old-age pension laws were enacted in California, Minnesota, Utah, and Wyoming.

1930: Old-age pension laws were enacted in Massachusetts and New York.

1931: Old-age pension bills were pending in 38 states during 1931. Laws were passed in Delaware, Idaho, New Hampshire, New Jersey, and West Virginia.

Previously passed laws were amended in Wisconsin, Colorado, Wyoming, Minnesota, and Maryland.

Nine years after Pennsylvania passed its first law which was found unconstitutional, it passed a constitutional amendment that would permit the enactment of an old-age pension law.

1933: More old-age pension laws were passed in this year than in any other year: Arizona, Indiana, Maine, Michigan, Nebraska, North Dakota, Ohio, Oregon, Pennsylvania, Washington, and Hawaii.

A law was also passed in Arkansas, but it was found unconstitutional during the year.

1934: In 1934, Iowa passed an old-age pension law, and earlier laws which had been optional in Maryland, Washington and Minnesota were made mandatory.

By the end of the year, 28 states and 2 territories had established old-age pension laws.

SOURCE: The Congressional Digest, Vol. XIV (March, 1935), p. 76.

funds and administration. An outline of the major features of the various laws enacted prior to 1935 is contained in Table 10.

For the most part, pensions were not to exceed $25-30 ($78-94) a month and were payable to persons at least seventy years of age who had resided within the state for a long period of time, generally fifteen years. Wealth limitations ranged from $300 of income to $3,000 of property. Frequently, recipients were required to turn all their property over to the pension administrator as well has have the value of all pensions deducted from their estates, upon death. In general, an elderly person could be denied a monthly pension for a number of reasons. If he: (1) was an inmate; (2) had financially responsible relatives; (3) deserted his family within a given number of years; (4) was a tramp or beggar; (5) disposed of property to qualify for the pension; (6) was a recipient of another government pension; or (7) failed to "work according to ability," then his pension application could be denied.[1]

It should be reiterated that state old-age pension laws were designed strictly as welfare schemes for the poor aged, not as insurance schemes. Further, they were clearly not designed to provide a "reasonable standard of living" but rather to provide the minimum

[1]"Efforts Seeking Old-Age Pensions," The Congressional Digest, Vol. XIV, No. 3 (March, 1935), p. 72.

TABLE 10

PRINCIPAL FEATURES OF OLD-AGE PENSION LAWS IN THE U.S., 1935

State	Date Enacted	Pension-able Age	Maximum Pension Payable	Residence Requirement	Property Limit	Annual Income Limit	Administration	Source of Funds	Enforce-ment
Montana	1923	70	$25/mo.	15 years	(a)	$300	County authorities	County poor fund	Optional
Nevada	1925	65	$1/day	10 years	$3,000	$390	County authorities	County treasury	Optional
Wisconsin	1925	70	Pension plus income may not exceed $1/day	15 years	$3,000	$365	County Judge	State-County-Town	Optional
Kentucky	1926	70	$250/year	10 years	$2,500	$400	County Judge	County	Optional
Colorado	1927	70	$1/day	15 years	$2,000	$365	County Judge	County	Optional
Maryland	1927	65	$1/day	15 years	- - -	$365	Circuit Court Judge	County	Optional
Utah	1929	65 and unable to work	$25/mo.	15 years	(a)	$300	County Com-missioners	County	Mandatory
Wyoming	1929	65	$30/mo.	15 years	(b)	$360	County Com-missioners	County poor fund	Optional
Minnesota	1929	70	Pension plus income may not exceed $1/day	15 years	$3,000	$365	County Dis-trict Judge	County	Optional

TABLE 10--Continued

State	Date Enacted	Pension-able Age	Maximum Pension Payable	Residence Requirement	Property Limit	Annual Income Limit	Administration	Source of Funds	Enforce-ment
California	1929	70	$1/day	15 years	$3,000	$365	County or city super-visor	State-County or Town	Mandatory
New York	1930	70	Adequate	10 years	Unable to support oneself	Unable to sup-port oneself	County or	State-	Mandatory
Massachusetts	1930	70	Adequate	20 years	Not speci-fied	Not speci-fied	Branch of public wel-fare ser-service	State-County or Town	Mandatory
Delaware	1931	65	$25/mo.	5 years	- - -	$300	State	State	Mandatory
Idaho	1931	65	$25/mo	10 years	(a)	$300	State wel-fare de-partment	County	Mandatory
New Hampshire	1931	70	$7.50/wk	15 years	$2,000	$300	County com-missioners	County-Town	Mandatory
New Jersey	1931	70	$30/mo.	15 years	$3,000	Unable to sup-port oneself	State and county wel-fare de-partment	State-County	Mandatory

TABLE 10--Continued

State	Date Enacted	Pension-able Age	Maximum Pension Payable	Residence Requirement	Property Limit	Annual Income Limit	Administration	Source of Funds	Enforce-ment
West Virginia	1931	65	$30/mo.	10 years	No income or property	No income or property	County Court	County	Optional
Arizona	1933	70	$30/mo.	35 years	(b)	$300	County old-age pension commission	State-County	Mandatory
Indiana	1933	70	$15/mo.	15 years	$1,000	$180	County commissioners	State-County	Mandatory
Maine	1933	65	$30/mo.	15 years	$300	$365	State welfare dept. and local old-age pension boards	State-County Town	Mandatory
Michigan	1933	70	$30/mo.	15 years	$3,500	$365	State welfare dept. and local old-age pension boards	State poll tax	Mandatory
Nebraska	1933	65	$20/mo.	15 years	(a)	$300	County commissioners	County poll tax	Mandatory
North Dakota	1933	68	$150/yr.	20 years	(a)	$150	State secretary of labor and county commissioners	State	Mandatory

TABLE 10--Continued

State	Date Enacted	Pension-able Age	Maximum Pension Payable	Residence Requirement	Property Limit	Annaul Income Limit	Administration	Source of Funds	Enforce-ment
Ohio	1933	65	$25/mo.	15 years	$3,000	$300	State welfare dept. and local old-age pension boards	State	Mandatory
Oregon	1933	75	$30/mo.	15 years	$3,000	$360	County old-age pension commission	County	Mandatory
Washington	1933	65	$30/mo.	15 years	(a)	$360	County commissioners	County	Mandatory
Pennsylvania	1934	70	$30/mo.	15 years	Indigent	Indigent	State welfare department	State	Mandatory
Iowa	1934	65	$25/mo.	10 years	(a)	$365	State old-age pension commission	State	Mandatory
Alaska	1915	65M 60F	$35M $45F	None	Insufficient means of support	Insufficient means of support	State	State	Mandatory
Hawaii	1933	65	$15/mo.	30 years	(a)	$300	Local old-age pension commission	County-City	Optional

TABLE 10--Continued

SOURCES: National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, Inc., 1931), pp. 58-60.

U.S. Committee on Economic Security, Supplement to Report of the CES (Washington, D.C.: Government Printing Office, 1935), Table 15.

Abraham Epstein, Insecurity: A Challenge to America (New York: Harrison Smith and Robert Haas, 1933), pp. 534-535.

[a]Only an income limit specified.

deemed necessary for the destitute aged as evidenced by maximum yearly payments of $360 ($1,120), and actual average yearly payments of only $204 ($634).[1]

Early Laws in Operation

Surveys were conducted in 1929 in order to determine the "success" of these early laws. At this time there were public pension laws in operation in Montana, Nevada, Wisconsin, Kentucky, Maryland, and Colorado. Keep in mind that these early programs differed from the majority of plans implemented during the Great Depression years as each of the original six plans were county optional. That is, administration and funding were strictly at the county level. Further, the decision to participate was made at the county level by a majority vote of the county's electorate, the county commissioners, or the county board. If implemented, a county could discontinue operations after one year.[2]

Table 11 shows the extent to which state old-age pension laws were actually implemented as of 1929. As indicated by the table, pension laws were completely inoperative in Maryland, and nearly inoperative in four of the five remaining states. Survey results indicated a number of reasons for the apparent lack of success of old-age pensions. Responding counties that opposed the laws suggested that:

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[1]"Old-Age Pension Laws in Operation," Bulletin of the U.S. Bureau of Labor Statistics, No. 491 (August, 1929), pp. 531-532.

[2]Ibid.

TABLE 11

OPERATION OF COUNTY-OPTIONAL STATE PENSION LAWS IN 1929

State	Year Adopted	Proportion of Counties Participating
Montana	1923	42/56
Nevada	1925	2/17
Wisconsin	1925	5/71
Kentucky	1926	3/120
Maryland	1927	0/24
Colorado	1927	1/63

SOURCE: "Care of the Aged in the U.S.," Bulletin of the U.S. Bureau of Labor Statistics, No. 491 (August, 1929), pp. 529-532.

(1) the pensions reduced self-reliance and promoted reliance on government; (2) compulsory tax support reduced the responsibility of children to their own parents; and (3) they would be subject to demands for increased benefits and reduced eligibility requirements. In essence, opponents of pensions cited that they were of no significant improvement over traditional almshouses and were undesirably costly. In general, those who supported pensions concluded that despite these arguments it was desirable for the elderly "to spend their declining years in self-respecting privacy without the stigma of pauperism."[1]

This survey and tabled evidence on the low survival power of optional pension schemes suggests two alternative interpretations. First, the evidence might shed doubt on the extent of broad demand-side pressure for old-age poverty relief, at least in the form of outdoor, cash payments. Second, if the cost of the welfare programs was the key concern, one could have predicted that there would arise demands for state or federal financial assistance, particularly as the extent of immigration (both interstate and international) and poverty increased. Indeed, the benefits of a decentralized system of poverty relief which permitted local control had to be weighed against the increased tax burden on local residents that could be dispersed by a more centralized scheme of finance.

Neither interpretation can be rejected. In fact, it seems most plausible that principles of individualism and local control were

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[1] Ibid.

enhanced by the alarming prospects for growth of welfare programs in constraining the emergence of pension programs. While it cannot be argued that the issue of old-age poverty was not a matter of foremost concern in many state legislatures, their institutional design and the means of implementing them certainly were.

By 1929, then, the private sector was responding to demands for protection against old-age financial insecurity, while attention was turning to the public sector, at a decentralized level, for alleviation of old-age poverty. The onset of the Great Depression later that year provided the needed impetus for advocates of central government action in the realm of social welfare.

The American Social Insurance Movement

The evidence presented to this point clearly suggests that there were no broad demand-side pressures for a compulsory, old-age insurance program prior to the onset of the Great Depression. In fact, the evidence is even somewhat stronger and indicates that there also were no discernible trends that would have likely culminated in broad demand-side pressures by the mid-1930's in the absence of the Great Depression.

Although broad demand-side pressures were lacking during this period, there were certain intense advocate groups that attempted, at various times, to build political momentum for centralized, compulsory old-age insurance or federal old-age welfare. The origins of these groups can be traced back to the pre-1900 period and also to Europe.

The Social Insurance Movement Prior to 1900

As pointed out previously, the major impact of the 1893 recession was to enhance the importance of voluntary cooperative organizations in responding to old-age financial insecurity. But, it also fed the fires of two small, intense groups that called for government action: the progressives who believed "social justice"--income redistribution--would be found in compulsory-collective welfare schemes, and the unionists who believed that employee benefit plans were an inconsequential means of combatting "worker insecurity." The former group, the first representatives of the social insurance movement in America, was small and still in the early stages of organization and publicity. The latter group, organized labor, was not yet behind the social insurance movement and generally believed that social justice was synonymous with a larger share of the wealth for workers in the form of higher current wages. Speaking to a group of charity organizationists in 1899, Samuel Gompers, the most outspoken labor leader, proclaimed: "More! More today, and more tomorrow; and then we shall want more and more . . . then I think you will find your eleemosynary occupations will be gone."[1]

For the alleviation of existing poverty, unionists and other advocates of social justice agreed in strongly supporting federal

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[1]Cited by Hace Tishler in Self-Reliance, p. 67.

expenditures on public works for the creation of employment as a possible alternative to public relief.[1]

Organized labor's opposition to early compulsory social insurance schemes is particularly interesting with the 1970's perspective as they have since then become a vital and powerful advocate group supporting a liberalized and expanded realm for social security. At least initially, social insurance was not viewed as being to their advantage but instead was viewed as potentially eliminating a key point of employee-employer bargaining.[2]

Social Insurance in Europe

By the close of the nineteenth century, the social insurance movement was underway in Europe but was not yet a serious topic of public debate in America.[3] European experience, however, provided American social reformers a diverse array of institutions from which to find a model for promoting within the United States.

In an early (1898), and classic book on social insurance, Willoughby classified European systems according to the role accorded the state in the various systems. The diversity of systems is clearly revealed by his work. Systems ranged from compulsory national

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[1] Ibid., p. 68.

[2] See Daniel Sanders, The Impact of Social Reform Movements on Social Policy Change (Fair Lawn, New Jersey: R. E. Burdick, 1973), pp. 131-141.

[3] Roy Lubove, The Struggle for Social Security, p. 25.

insurance (Germany: accident, sickness and old-age insurance), to private unregulated insurance funds (England: insurance provided by mining and railroad industries). Between these two extremes were voluntary state insurance programs (France: accident, heath, old-age, and invalidity), and voluntary, but regulated, insurance societies (England: fraternal insurance).[1]

Throughout Europe, the general pattern of establishment of compulsory public programs was workmens' compensation first, followed by national health insurance next, then old-age insurance, and then, finally, unemployment insurance. In each case, Germany was the first country to establish compulsory social insurance--health insurance (1883), workmens' compensation (1884), and old-age insurance (1889), all at the national level.

Under Germany's workmens' compensation law, employers were required to carry insurance on their employees through mutual trade associations. Similar programs emerged in Austria, Hungary, Norway, and Luxemburg, whereby insurance was compulsory, but the carriers were territorial associations. Norway represented the extreme in terms of specified carriers. Employers were required to purchase insurance from a monopoly state fund. Additional compulsory systems were established in Italy, Finland and the Netherlands, placing financial liability on employers, however, the source of insurance remained

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[1]For a discussion of these early European plans, see Ibid., pp. 25-29.

optional whereby employers could carry insurance privately or publicly. Finally, a scheme implemented in England (1897), which required compensation rather than insurance, was later adopted in Belgium, Denmark, France, Greece, Russia, and Spain.

By the turn of the century, and to a lesser degree, compulsory national health insurance was developing in Europe. Germany (1883), again, led the development, followed by Austria (1888), Hungary (1891), and Luxemburg (1901). Compulsory old-age insurance was the development latest in Europe. Prior to the twentieth century, only Germany (1889) had such a scheme. By 1900, however, Denmark, New Zealand, Australia, and France had inaugurated tax supported old-age pension programs. At this time, there were no unemployment insurance plans.

As a point of reference, it is interesting to note that not only were there no compulsory state insurance programs in the United States, but also one-fourth of the states did not have central administration of relief, and one-fourth of the states retained the constitutional authority to deny recipients their civil rights.[1]

The Influence of the European Movement

The implementation of a number of compulsory social insurance laws in Europe prior to 1900 had a minimal impact on American thinking and public debate. Within the following fifteen years, however, not

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[1]Hace Tishler, Self-Reliance, p. 81.

only did compulsory insurance become a general trend in Europe, but also it became a live issue of public debate in America. The charity workers, social reformers, intellectuals, socialists, and other "progressives," became the core of advocates for compulsory social insurance.[1]

By 1915, compulsory social insurance was fairly widespread in Europe. In addition to those plans inaugurated before 1900, compulsory national health insurance emerged in Norway (1909), Great Britain (1911), Russia (1912), and the Netherlands (1913). Compulsory contributory old-age insurance plans were enforced in Austria (1906) and France (1910). Russia, Belgium and Italy had compulsory old-age insurance systems, as well, but they were limited to workers in particular industries. In 1908, England adopted a tax supported pension plan rather than insurance. Other countries which had enacted some type of major legislation for old-age insurance included Australia (1906), Czechoslovakia (1906), Ireland (1908), Iceland (1909), Luxemburg (1911), Netherlands (1913), and Rumania (1912).[2] Table 12 indicates that by 1929, twenty-five nations in Europe, Africa, South and Central America, plus New Zealand, Australia, and Canada had implemented some type of national program for old-age insurance.

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[1]See Walter Trattner, <u>From Poor Laws to Welfare State</u>, p. 151; and Hace Tishler, <u>Self-Reliance</u>, pp. 80-104.

[2]See Roy Lubove, <u>The Struggle for Social Security</u>, pp. 28-29.

TABLE 12

YEAR OF ENACTMENT OF THE FIRST MAJOR OLD-AGE INSURANCE LAWS THROUGHOUT THE WORLD

Before 1900	1910-1919	1920-1929
Germany, 1889	France, 1910	Cuba, 1921
Denmark, 1891	Luxembourg, 1911	USSR, 1922
New Zealand, 1898	Rumania, 1912	Brazil, 1923
	Netherlands, 1913	Chile, 1924
1900-1909	Sweden, 1913	Belgium, 1924
Austria, 1906	Italy, 1919	Bulgaria, 1924
Czechoslovakia, 1906	Spain, 1919	Canada, 1927
Ireland, 1908		Poland, 1927
United Kingdom, 1908		Uraguay, 1928
Australia, 1908		Hungary, 1928
Iceland, 1909		
		1930-1935
		Portugal, 1933
		Greece, 1934
		Ecuador, 1935
		United States, 1935

SOURCE: Joseph A. Pechman, Henry Aaron, and Michael Taussig, Social Security: Perspectives for Reform (Washington, D.C.: The Brookings Institute, 1968), p. 276.

The many compulsory insurance programs in Europe had dual and conflicting effects on the social insurance movement in America. First, they provided inspiration to the growing number of advocates of "social justice," and formed the basis for a great number of books written at the turn of the century. Second, and perhaps more important, the introduction of compulsory insurance in Germany was an important source of opposition by the many critics of compulsory government intervention in the private sector.[1] It was widely known that the German programs had been introduced by Otto von Bismarck to advance autocratic militarism and squash socialism. To the alarm of individualists, socialism was thought to prosper after the program's introduction.

As early as 1904, the social insurance and pension movements had been associated with German inpetus. In that year, the St. Louis Exposition contained elaborate exhibits prepared by the German government lauding the merits of compulsory insurance, when in fact, mounting costs were plaguing Germany's international economic position.[2] Also, Germany had established the International Association for Labor Legislation which gave rise to the American Association for Labor Legislation--the organization that initiated the social insurance movement in

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[1]See, for example, Frederick L. Hoffman, "Autocracy and Paternalism vs. Democracy and Liberty;" Facts and Fallacies of Compulsory Health Insurance; and More Facts and Fallacies of Compulsory Health Insurance.

[2]Roy Lubove, The Struggle for Social Security, p. 7.

America. Finally, many of the progressive intellectuals of the period had been German trained or, at least, influenced by the German school of thought. All of these factors contributed to a widespread concern that social insurance was an "alien importation," and advocates were often attacked on this point.[1]

Organization of the American Movement and Its Opposition

The American Association for Labor Legislation (AALL), established in 1906 as a branch of the German created International Association for Labor Legislation, is perhaps the single organization which can be pinpointed as having created and sustained the social insurance movement in America. The AALL's leadership, comprised mainly of university professors and social scientists, included John R. Commons and Richard Ely (Wisconsin), Henry Farnam (Yale), J. W. Jenks (Cornell), Samuel McCune Lindsay and Henry Seager (Columbia). Among its non-academic economists were John B. Andrews, Adna F. Weber, and Isaac Rubinow, of whom the latter certainly became the most prolific.[2] The establishment of the AALL marked an important link between the study of social problems, policy initiation, and "intellectuals." Social reformers of the late nineteenth century joined with the university faculty in their advocacy of "social justice."

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[1]Ibid., pp. 6-10.

[2]Ibid., pp. 29-44.

What can be said, in general, about the theme of the social insurance movement? As early as 1920, there existed divergent opinions, even among the members of the AALL, concerning the primary purpose of social insurance--prevention of worker insecurity through insurance or maintenance of worker security through income redistribution. In either case, however, the movement in America, as well as abroad, aspired toward centralization and collectivization to reap the gains of a "more secure working class." Advocates found the United States and the conditions of workers "pitifully" behind the rest of the civilized world.[1]

Andrews and Commons professed a conception of social insurance for the prevention of worker insecurity. In their words, "In all the work we've done together we have thought first of prevention and second of relief in dealing with each form of social insurance in this country."[2] Universal, compulsory coverage would force all employers, especially the less progressive, to contribute to the well-being of the working class. By making resources available should the worker's income be interrupted by illness, disability, unemployment, or old-age,

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[1]In 1929, Governor F. D. Roosevelt said, "I am appalled everyday by the number of people writing to protest that they hope that the United States will no longer remain in the class with Mexico and China as the only two countries which have made no provision for the care of the aged." Cited in "Three States Adopt Old-Age Pensions," Bulletin of the American Association for Old-Age Security, Vol. III, No. 4 (April, 1929), p. 1.

[2]Cited by Roy Lubove, The Struggle for Social Security, pp. 42-43.

employers would be helping to alleviate a problem which they, it was claimed, had helped create. Rubinow, on the other hand, advocated the maintenance of a decent living standard for all workers. As such, social insurance was the vehicle through which "social justice"--income redistribution--could be attained. Since the government had the resources and the responsibility to make workers more secure, he thought, social insurance should be financed by federal general revenues.

Isaac Rubinow, a Russian who emigrated to the United States in 1893, epitomized the challenge to voluntarism inherent in the social insurance movement. His conception of social insurance is of particular interest as it drew heated debate and brought to glaring attention a view of the world and of the role of the state embodied by staunch social insurance advocates. His views, as expressed in a series of books, articles, and speeches, attacked the core of traditional values such as thrift and self-reliance.[1]

Worker insecurity, Rubinow explained, was an outgrowth of an economic system which distributed rewards on the basis of work. Since nearly the entire population worked for their livelihood, nearly

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[1] Ibid., pp. 34-44. For samples of his work, see Social Insurance: With Special Reference to American Conditions (New York: Henry Holt and Co., 1913); "Compulsory Social Insurance of Workingmen," Annals of the American Academy of Political and Social Science, Vol. XXIV (July-December, 1904); pp. 331-342; The Quest for Security; and "Is the Administration's Plan for Old-Age Pensions Sound?" The Congressional Digest, Vol. XIV, No. 3 (March, 1935), pp. 88, 90.

everyone faced economic insecurity. Apparently, one's command over goods and services was viewed as being tied singly to one's current flow of wage income. As such, "the slightest interruption or reduction in wages or any increase in expenditures immediately condemns them to defenseless poverty."[1] In the words of one of Rubinow's avid followers, Abraham Epstein,

> Ever since Adam and Eve were driven from the sheltered Garden of Eden, insecurity has been the bane of mankind. The challenge confronting us in the twentieth century is that of economic insecurity, which weighs down our lives, subverts our liberty, and frustrates our pursuit of happiness. The establishment of economic security has become a paramount issue because our modern system of industrial production has rendered our lives insecure to the point of despair. The wage system has made economic security depend entirely on the stability of our jobs. Such utter dependence upon a wage for the necessities of life has never before been known in any society.[2]

The greatest injustice of a free functioning market economy, said Rubinow, was the impact of fear and worry on worker morale. In his words, "economic hazards give rise to a great deal of worry which often assumes the acute form of fear."[3] Crucial to his line of reasoning was a rejection of traditional values of thrift. Saving and investment against future contingencies were not the answer because they were thought to be out of reach of the majority of low wage earners and also because it was not good for moral fiber. "When this situation

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[1] Abraham Epstein, Insecurity, p. 6.

[2] Ibid., p. 3.

[3] Isaac Rubinow, The Quest for Security, p. 31.

exists ['self-denial for fear of the uncertain dangers of the future'], wise foresight creates nothing more useful than neurotic anxiety states."[1] In response to the large annual increases in savings during the 1920's, Rubinow proclaimed, "do we fully realize what such increasing tendency to saving will do to the soul of the American workman and the souls of his children.[2]

Much of this can pass without judgment, for indeed it represented little more than a different view of the world than was possessed by most Americans before the Depression.[3] Collective insurance was designed for a much more fundamental purpose than "insurance." Despite all the attempts to riddle the literature with reminders of cost reductions associated with broad-scale insurance, the much more fundamental issue was that of income redistribution. Social insurance was viewed as having a dual function--compensating the worker for losses of income associated with the risks of unemployment, disability, or old-age--and more importantly, raising the standard of living for the wage earners. While the insurance function, per se, could have been met through alternative means, although the government was deemed most efficient, the income redistribution function required

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[1] Ibid., p. 32.

[2] Ibid., p. 34.

[3] In fact, one of his early articles on unemployment insurance was rejected in 1903 by one of his former professors at Columbia University as "too un-American and revolutionary" for the Political Science Quarterly. See Roy Lubove, The Struggle for Social Security, p. 34.

coercive state action. By requiring universal coverage and universal tax support, a "more equitable" distribution of income could be attained. Rubinow admitted that the policies were "true class legislation."[1]

From today's perspective, the advocates of social insurance for prevention supported more moderate proposals. During the pre-Depression years, however, these too were radical. Overall, a very poor greeting was accorded the social insurance movement; for indeed, it attacked the principles of individualism and voluntarism so characteristic of the period: individual liberty, limited government, self-support, and an economic incentive system. The proposals were denounced as socialistic, communistic, and at least, paternalistic since social insurance was a system based on compulsion and alien to American traditions of thrift and self-reliance. Further, these proposals would have required the establishment of a huge federal bureaucracy in competition with the private sector which, it was feared, would continue to grow, erode individual liberty, and eventually be indistinguishable from programs designed explicitly to redistribute income.[2]

In addition to the movement's association with German origins, the movement was damaged by its early association with "intellectuals."

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[1]Roy Lubove, The Struggle for Social Security, p. 38.

[2]The arguments are discussed more fully in Chapter III.

Typical progressive reformers were characterized as "people of comfortable economic circumstances, working in a professional or quasi-professional capacity for a university, magazine, civic service society, or the government."[1] It is no wonder that organized labor hesitated to support early social insurance advocates, as many believed the intellectuals' appropriate role ought to be advisory to leadership by labor, without the pretense of formulating policy for the "general will."[2]

Opponents of social insurance included organized labor, business interests, most notably private insurance, and the many patriots of individualism. A resolution to place the AFL on record as supporting national old-age pensions failed in 1905--higher wages were preferred to deferred benefits.[3] In Gomper's words, "This fundamental fact stands out paramount, that social insurance cannot remove or prevent poverty."[4]

In 1908, the National Civic Federation, an employer's group, devoted their annual meeting to the topic of old-age dependency. The president of New York Life Insurance Company said at that time,

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[1]Hace Tishler, Self-Reliance, p. 75.

[2]Roy Lubove, The Struggle for Social Security, pp. 33-34.

[3]Hace Tishler, Self-Reliance, p. 88.

[4]Cited by Frederick Hoffman in Facts and Fallacies, p. 62.

> A system which teaches these people how to protect themselves against this menace is more in harmony with the genius of our institutions, than a system which coerces them into action or a system which finally places the burden of their support and care upon general society.[1]

"The genius of our institutions" was a recurring theme. People pointed to the ability of the private sector to meet the contingencies of old-age insecurity. The nineteenth and early twentieth centuries had witnessed the innovation of various forms of savings and investment for old-age. Fraternals, private individual and group life insurance, industrial pension plans and postal savings accounts (instituted 1911) were all among the various means which had emerged in the private sector to relieve old-age insecurity. As economic conditions worsened, thus heightening the risk of financial insecurity, private institutions had flourished. If poverty was the problem, public relief at a decentralized level was emerging to supplement private charity, the family and the church.

One of the more prolific opponents of compulsory insurance, Frederick Hoffman, of Prudential Life Insurance, aptly reflected the views of opponents when he claimed the social insurance movement was a "propoganda for paternalism and coercion," and

> the duty of every American to resist unnecessary coercion or compulsion, but especially in a field of effort and enterprise which has heretofore been chiefly, if not exclusively, a matter of personal concern.[2]

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[1]Cited by Hace Tishler in <u>Self-Reliance</u>, p. 84.

[2]Frederick Hoffman, <u>Facts and Fallacies</u>, p. 6.

The wise majority of Americans who opposed social insurance were, he said,

> those who believe not only in insurance but in every other form of voluntary thrift lies the ultimate solution of the problem of poverty, dependency, and destitution, and not through compulsion, coercion, government rules and regulations, social classification and stratification, all of which are opposed to the true principles of liberalism in our American democracy.[1]

On The Eve of The Great Depression

For the most part, social insurance advocates recognized they were fighting a losing battle by the end of the 1920's.[2] The movement had suffered a bitter defeat in the way of national health insurance, and emerging state old-age pension laws and flourishing private savings and insurance were taking much of its remaining strength. The early state pension laws were attacking the problem of old-age dependency at the decentralized level, and detracting attention from the "need" for federal old-age insurance; for indeed, the likely success of the insurance movement relied heavily on the existance of

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[1]Ibid., p. 83.

[2]See Isaac Rubinow, The Quest for Security, pp. iii-iv. Pondering the question of why there was such a delay of federal action in the United States relative to Europe, Rubinow concluded it was due to a "difference in state of mind which . . . refers to the functions of government. . . . It takes an AALL, an AAOAS. . . through education, propaganda, wire-pulling, and sometimes unaesthetic lobbying to pass an act, sometimes jam it down unwilling throats, not only of legislators, but even labor itself." See Ibid., p. 604.

unattended or growing poverty as a priori justification for future prevention. For those advocates of social insurance for redistributive purposes, state welfare programs limited the possibility of implementing comprehensive federal programs with the dual redistribution-prevention function.[1]

Further, there were few signs to indicate that social insurance was becoming more viable politically. The Hoover era was disinclined to support large, costly, government programs. President Hoover's attitudes toward federal intervention in the realm of social welfare reflected the traditional American values of limited government and individual liberty. These values of the pre-Depression period were not negative, or neglectful of the needy, as social insurance advocates suggested, but instead, embodied

> a positive philosophy: that personal prosperity was a matter of personal responsibility; that it was up to the individual to work, save, and succeed; and that the inventiveness of America, its vitality, and its strength, lay in the self-reliance of Americans.[2]

As a sign of the times, and in order to grasp the significance of the Depression and Roosevelt on the introduction of compulsory

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[1] In fact, Rubinow claimed that Hering's efforts toward voluntary state old-age pension laws had "very nearly destroyed" the value of earlier efforts for compulsory income maintenance programs. See Isaac Rubinow, The Quest for Security, p. 278.

[2] Frederick L. Allen, "Economic Security: A Look Back and a Look Ahead," in Social Security: Programs, Problems, and Policies, ed. Wilbur Cohen and William Haber (Homewood, Illinois: Richard D. Irwin, 1960), p. 32.

insurance in America, it is important to note that prior to 1929, no bills for federal aid to the needy aged or compulsory insurance were reported out of committee. Even after the onset of the Depression, Hoover rejected pleas for federal action, stating, "You cannot extend the mastery of government over the daily lives of the people without at the same time making it the master of their souls and thoughts."[1]

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[1]Cited by Walter Trattner, From Poor Laws to Welfare State, p. 231.

Chapter III

THE EMERGENCE OF SOCIAL SECURITY: THE IMPACT OF THE GREAT DEPRESSION, PRESIDENT ROOSEVELT, AND SOCIAL INSURANCE ADVOCATES

Introduction and Summary

Purpose and Scope

Given the findings in Chapter II which indicated a lack of broad-based demands for compulsory old-age insurance prior to the 1930's, it is the central purpose of this chapter to determine what the underlying economic and political changes were that led a majority of elected representatives to support a compulsory, federal, old-age insurance program in 1935 when there had been no Congressional consideration of this type of program prior to this time. Alternatively, the chapter examines whether or not pure demand-side models of public sector activity can adequately explain the timing, acceptance, and form of social insurance in the United States.

These issues become particularly important when one is confronted with the evidence on the trend toward centralization of old-age welfare activities and federalization of old-age insurance before and after the onset of the Depression. Prior to the Depression, only a handful of bills for national old-age pensions (poverty relief) had been introduced into Congress, none of which were reported out of committee. No bills had been introduced into Congress for compulsory old-age insurance; and only six states had enacted old-age pension laws, all of which were county-optional. By 1934, old-age pension laws had been enacted in twenty-eight states plus Hawaii and Alaska, twenty of which were mandatory; and the first bill calling for federal grants to states with pension laws was reported in Congress with unanimous approval from both committees.

In that same year, however, some five years after the onset of the Depression, a leading proponent of social insurance conceded that the majority of the working population did not "clamour" for social insurance and that "in practically all of Europe, it was governmental authority that was behind social insurance measures."[1] Some five years after the onset of the Depression, there still had not been a bill introduced into Congress for compulsory old-age insurance. By August, 1935, however, President Roosevelt had seen enacted in the Social Security Act a comprehensive system of compulsory old-age insurance along with a tax-offset system of unemployment compensation, and grants to states for old-age poverty relief, maternal and child welfare, public health, aid to dependent children, and the blind.

With this perspective in mind, the speed with which such pervasive and unprecedented federal action was undertaken is remarkable.

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[1]Isaac M. Rubinow, The Quest for Security (New York: Henry Holt and Co., 1934), pp. iv, 605. The author went on to ask, "Will it be Bismarck, Lloyd George and--Franklin D. Roosevelt?" Ibid., p. 606.

Only a year elapsed between the time Congress seriously considered federal programs to aid the elderly poor and the time Social Security was enacted. The only bill ever introduced into Congress for compulsory old-age insurance was the bill that was passed eight months later as the Social Security Act.

It is to this phenomena that Chapter III is addressed. What were the key factors accounting for the rapid enactment of the law? What was the impact of the perceived failure of private markets on demands for government action? Moreover, what were the key factors influencing the institutional design of the old-age insurance program? Indeed, what was the impact of President Roosevelt's appointment of a Committee on Economic Security (CES) which was independent of Congress in drafting the proposed legislation? What was the impact on the ultimate design of the new law of staffing this committee with existing bureaucrats and social insurance advocates?

To address these questions, this chapter examines the general economic and political climate between the onset of the Great Depression in 1929 and the emergence of compulsory social insurance in 1935. To provide insight into the political atmosphere that gave rise to the Act, the chapter is devoted in some detail to the drafting of the law, the major issues of debate, and seriously considered alternative proposals.

The Depression and Demands for Government Action

The Great Depression, a poorly understood economic phenomena thought to be widespread "market failure," served to destroy the private sector reliance characteristic of the pre-Depression years. The economic incentives and rewards produced by the market economy failed to provide protection or security. Importantly, the Depression threatened two primary means of support in old-age: private savings and continued employment. Between 1929-1933, one-fifth of all commercial banks failed, and unemployment reached a quarter of the labor force.[1] In the three and one-half years between September, 1929, and June, 1932, the real value of all stocks and bonds listed on the New York Stock Exchange fell nearly 80 percent; and by 1934, real personal savings had fallen $33 billion.[2]

> It was during those years--and especially during the early 1930's, when the survival of American capitalism seemed almost a matter of touch-and-go--that a lasting change took place in the attitude of American people toward their economic and political institutions.[3]

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[1]See Milton Friedman and Anna J. Schwartz, A Monetary History of the United States: 1867-1960 (Princeton: Princeton University Press, 1963), p. 299.

[2]Abraham Epstein, Insecruity: A Challenge to America (New York: Harrison Smith and Robert Haas, 1933), p. 14; and U.S. Bureau of Census, Historical Statistics of the United States, p. 266. All real figures have been deflated by the 1975 CPI.

[3]See Frederick Allen, "Economic Security," in Social Security: Policies, Problems, and Prospects, ed. Wilbur J. Cohen, p. 30.

With seventeen million persons on direct relief from all levels of government in 1933, there emerged broad-based demands for government action to aid the poor and unemployed.[1] As opposition to state administered old-age pension laws withered, new laws emerged. Just as had been the case prior to the Depression, however, there was still no significant demand-side pressure for compulsory old-age insurance. As the Depression worsened and the financial conditions of states deteriorated, public sentiment moved toward the consideration of federal grants to states enacting their own old-age pension laws. In fact, by 1934, a majority of states had enacted old-age pension laws, and a bill calling for federal grants to states with pension laws was reported with unanimous support from both of its review committees in Congress.

Roosevelt, Social Insurance Advocates, and the Supply of Government Action

Given emerging demand-side pressure for government action in response to the poverty generated by the Depression, a number of factors appear paramount in explaining both the timing and form of the original Social Security Act, the first of which was the role played by President Roosevelt. In contrast to the limited government philosophy of the Hoover Administration, President Roosevelt embodied the progressive

[1] Daniel Sanders, The Impact of Reform Movements on Social Policy Change (Fair Lawn, New Jersey: R. E. Burdick, Inc., 1973), p. 51.

principles of social and economic reform through government intervention. Responding to the Depression crisis, Roosevelt announced his intentions

> . . . by lawful, constitutional processes to reorganize a disintegrating system of production and exchange . . . The reorganization must be permanent for all the rest of our lives.[1]

Indeed, the Roosevelt Administration took the economic disaster and led a massive expansion in the role of the federal government.

Rather than encourage Congress to hasten its examination of pending legislation for the poor and elderly, Roosevelt created, by Executive Order, the Committee on Economic Security (CES) to study and draft a program of Social Security. The Committee and its staff were not only independent of Congress in drafting legislation but also manned by top level cabinet members and established social insurance advocates--those persons with vested interests in advancing a permanent, federal program. Any one of a number of programs ranging from federal-state relief programs to subsidized or insured private insurance plans, might have satisfied citizens' demands for old-age "security," yet social insurance advocates stood ready to articulate specific institutional packages to satisfy citizens' yet unarticulated demands for federal action.

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[1]Speech delivered March 5, 1934 to a meeting of the NRA; cited in <u>Cong. Rec</u>. (June 22, 1935), p. 9906.

The comprehensive report of the CES, which was introduced into Congress in January of 1935, was passed largely in its entirety only eight months later.

Of what significance is this? Indeed, if the CES were simply one of many competing suppliers of policy proposals, there would be little significance to who drafted the original bill. It is suggested, however, that the creation, staffing, and funding of the CES with the purpose of formulating a Social Security program secured for the Committee unusual "market power" in determining the outcome of the collective choice process. In any real sense, the CES and other advocates effectively dominated the information presented Congress and the public, secured particular control over the legislative process, and were able to "profit" from tying a number of seemingly unrelated programs into a single legislative bill.

The bill that went to Congress, drafted by persons who later became members of the Social Security bureaucracy, incorporated a skillful combination of politically appealing relief measures tied to less appealing compulsory insurance titles. The welfare provisions of the Social Security bill, which were designed to create federal-state matching grant programs, had broad-based political support from both conservative and liberal Congressmen as they would have made available federal funds for the immediate relief of the aged destitute while granting states optional participation. Similarly, they provided an attractive incentive for less progressive Southern and Western states--those states with relatively large minority groups--to enact state welfare laws.

The old-age insurance plan, on the other hand, was staunchly opposed by conservative Congressmen, business interests, advocates of limited government, and others as well. There was simply no persuasive reason that the government ought to monopolize old-age insurance, and coerce participation. Moreover, it was not even clear that the government was constitutionally permitted to do so. What was clear, however, was that social insurance advocates' insistence upon a federal program, and a compulsory program, reflected their desire not only to permeate the private sector with governmental authority, but also to use the political process to redistribute income.

It was evident to most Congressmen that there were no logical reasons to combine a complex and permanent program with the many relief titles in a single legislative bill, beyond the fact that it made passage of the former more likely. Indeed, by tying the creation of a whole series of temporary relief programs to the acceptance of a permanent, compulsory, old-age insurance program, the CES insured itself of particular power over the legislative process. The presentation to Congress of an all-or-nothing package discouraged, if not prevented, careful scrutiny of the individual titles, and put Congressmen in the position of supporting all measures or being labelled in opposition to "Social Security." In the words of Paul Douglas, an active proponent of social insurance in the 1930's,

> Many congressmen were opposed to the omnibus character of the measure and resented the Administration's attitude that it must be all-or-none [italics mine]. There were many who did not like to be forced to adopt a vast series of untried measures in the original drafting of which they had had no part.[1]

The overlapping group of social reformers, social insurance advocates, and CES members had yet another source of control--they effectively dominated the information presented Congress and the public. This source of power was simply an outgrowth of the fact that they had very clear incentive not only to gather information, but also to take an active role in disseminating it. For years before the Depression, social insurance advocates had studied the early German and other European social insurance systems. As advocates and high demanders of "social justice," their endeavors rarely included studies of the functioning and relative advantages of American savings and insurance institutions.

As discussed in Chapter I, there was a clear incentive on the part of advocates to use this information to affect the outcome of the collective choice process. A job in the newly created bureaucracy, a staff position in Congress, consulting and research opportunities, and jobs for colleagues were but a few of the direct benefits that

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[1] Paul H. Douglas, Social Security in the United States: An Analysis and Appraisal of the Federal Social Security Act (New York: McGraw Hill Book Co., Inc., 1939), p. 99.

advocates could expect to receive in return for their successful "lobbying." Moreover, these activities were not infrequently subsidized, since many advocates were currently employed in the types of employment that facilitated, if not funded, research in support of government programs such as government bureaus, the CES, universities, and social work.

Opponents of Social Security, on the other hand, could expect to receive no direct benefits from blocking the old-age insurance titles that would not have been shared collectively by all other opponents, while the costs of these activities, in many cases, would have been born directly. Because of the inherent publicness of these activities, then, an underinvestment in lobbying against Social Security was predictable. In essence, even if the CES had not been created to supercede Congress, and had not presented Congress with a complex tied package of institutions, we could have predicted that competing sources of information would have been outweighed by the information made available by supporters of the old-age insurance program.

This discussion is not intended to suggest that the features of the old-age insurance program were unconstrained or without support. To the contrary, as the bill made its way through Congress, a pay-as-you-go system of finance with government contributions was abandoned and replaced by a fully-funded program. Moreover, the program was limited in scope relative to both the early proposals advanced by advocates and the program in the 1970's, and "promised" a positive rate of return on worker's tax payments. What is suggested, however, is that many more limited programs could have mustered political support as well as that there is little reason to expect that an old-age insurance program modeled after Germany's would have emerged from Congress had it not been presented to Congress by the CES. Indeed, as an indication of the lack of broad-based support for old-age insurance, despite the fact that the Administration had made it clear that welfare funds might be slow to materialize were the entire package not accepted, the proposal to eliminate the old-age insurance titles completely mustered nearly 30 percent of the votes cast in the House.[1] In addition, the one amendment to the Social Security Act that ultimately stalemated the conference committee was Senator Clark's proposal to allow the "contracting out" of firms covered by private insurance plans that could provide at least as generous cost-benefit bundles as could the federal government.[2]

The Social Security Act

As enacted on August 14, 1935, the Social Security Act constituted an unprecedented expansion in the role of the federal government and a constitutional level change in the delineation of rights of the collectivity. In only twenty-nine pages, the Act was divided into ten titles which created one federal, compulsory program, old-age

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[1]Ibid., p. 109.

[2]Ibid., pp. 120-125.

insurance; a federal-state tax-offset program for unemployment compensation; three federal-state categorical grant programs, old-age assistance, aid to dependent children, and aid to the blind; and two federal-state nonuniform grant programs for maternal and child welfare and public health.[1]

With a 1970's perspective, the original old-age insurance program was simple, relatively narrow in scope, and had some attributes of a private insurance program. There was only one beneficiary category, the eligible retired worker, and the objectives of the program were clear: (1) benefits directly related to earnings, payable to covered workers only; (2) limited coverage; and (3) fully-funded. While the benefit formula tended to favor workers with lower incomes, the redistributive impact was relatively small, and the tax-benefit link was direct. Like private insurance, benefit tables had been designed to insure that every worker received at least what he had paid in taxes (employees' share only) plus interest, and importantly, that all workers with the same earnings histories were entitled to exactly the same monthly benefits. Finally, both benefit levels and tax rates were modest. The initial combined payroll tax was only 2 percent, scheduled to rise to a maximum of 6 percent in 1949. Monthly benefits ranged from $10 ($39) to $85 ($333), and covereage was limited to 6 out of 10 workers--those least likely to be able to afford private

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[1]Social Security Act, Pub. No. 271, 74th Cong. [HR 7260]; Approved August 14, 1935.

insurance.[1] At that time, there was no intention of providing a "reasonsble standard of living" through the old-age insurance program. It was intended strictly as a means to supplement private sources of retirement income.

In essence, then, the original Social Security Act institutionalized three important constraints on the ability to use the old-age insurance program as a means to redistribute income, both intragenerationally and intergenerationally. Since the program was designed to be fully-funded ultimately, the ability to finance program expansion by postponing tax costs to future generations was constrained. Moreover, by restricting coverage to lower paid workers and by restricting benefits to worker-taxpayers only, the ability to employ the program as a means of redistributing income between beneficiaries was constrained as well. Indeed, had the program maintained these objectives as benchmarks against which to consider amendments to the Act, the scope and growth of the program would have been significantly limited as they defined, in some senses, a range of permissable fiscal outcomes.

As program advocates undoubtedly recognized, however, Social Security could do no more than bestow statutory rights to taxpayers, as opposed to contractual rights. As such, the institutional constraints embedded in the law which might have limited the future growth and redirection of the program were merely statutory and therefore subject

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[1]All dollar figures in parentheses have been calculated on the basis of 1975 prices.

to Congressional discretion. Moreover, the choice of a tax without a generally perceived incidence was likely to reduce opposition to future expansion. Finally, the fact that benefits were proportionately but not directly related to earnings confounded the distinction between the objectives of the old-age insurance and old-age assistance programs so that quantitative standards for evaluting future changes in the benefit formula were lacking.

Summary: Supply-Side Control Over the Old-Age Insurance Program

In sum, the evidence presented in this chapter suggests that the Great Depression, President Roosevelt, and social insurance advocates played major roles in the timing, acceptance, and form of the original Social Security Act. On the demand-side, the perceived failure of private savings and insurance institutions, and the dramatic increase in unemployment concomitant with the onset of the Depression, led to a reevaluation of the relative costs and benefits of federal government action and generated an environment conducive to the emergence of new government institutions. Importantly, however, there were many ways that these demands for old-age "security" could have been satisfied. Rather than marking a "new awareness" on the part of Americans to the needs of the poor and elderly, or the institutionalization of broad-based demands for social insurance, the emergence of compulsory old-age insurance marked the culmination of the combined efforts of supply-side agents who included President Roosevelt, the CES, and other social insurance advocates.

In essence, the evidence presented in this chapter would be consistent not only with the hypothesis that the major objectives of the Social Security Act, in particular, poverty alleviation, were supported by broad-based citizens' demands, but also with the apparently paradoxical hypothesis that the institutionalization of compulsory, old-age insurance was not the outcome of a competitive or democratic political process. The control over information maintained by "advocate-experts" and their ability to tie a series of seemingly unrelated titles into a single legislative bill permitted the passage of a compulsory, federal old-age insurance program that alone clearly would not have gained passage during the 1930's. As such, the fact that the original old-age insurance program had several attributes of a private insurance program and was relatively narrow in scope should be viewed not so much as the outcome of a democratic compromise between the demands of advocates and the demands of opponents as the political outcome of a voting process in which the agenda was controlled.

The Great Depression and Demands for Government Action: 1929-1934

In destroying the private sector reliance characteristic of the pre-Depression period, the Great Depression created an environment conducive to demands for government action; for indeed, the economic rewards and incentives produced by the market had seemingly failed to provide protection or security. The collapse of private banking and savings institutions and sustained high rates of unemployment, particularly acute among the elderly, threatened two vital means of financial support for persons of all ages. Between 1929 and 1933, the real value of gross private savings fell more than $38 billion, and by 1933, nearly one out of every four workers were unemployed.[1] As late as January, 1935, some twenty-one million persons, or 17 percent of the population, were receiving emergency direct or work relief from the various levels of government.[2]

It was in the midst of this economic environment that advocates of social insurance, social reformers, and New Dealers realligned to amass political support for the same programs they had been advancing unsuccessfully for thirty years. Whereas the prosperous decade of the 1920's had all but paralyzed the social insurance movement, the depression provided a political climate conducive to progressive demands for the federalization of many activities, only one of which was old-age insurance.[3] Advocates fueled the notion that the Depression was the failure of a "wage-based" economy, or in the words of President

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[1] U.S. Bureau of Census, Statistical History of the United States, p. 266. Also, it has been estimated that unemployment among the elderly rose from 26.2 percent in 1890 to 41.7 percent in 1930. See Paul Douglas, Social Security in the U.S., p. 20.

[2] Daniel Sanders, The Impact of Social Reform Movements, p. 51.

[3] Abraham Epstein, an early social insurance advocate, admitted "the movement . . . . suffered a serious setback during the prosperity boom. The leadership of the movement was silenced and interest waned;" in Insecurity: A Challenge to America, p. vii.

Roosevelt, the product of a "disintegrating system of production and exchange." For them, the Depression provided final evidence that reliance on a market economy was the reliance on an unstable, insecure, and unjust economic system.[1] To opponents of government action, the fact that governmental failure may have underlay the economic debacle was of little consolation.

The State Old-Age Pension Movement

Opposition to the extension of old-age poverty relief withered during the Depression, and the 1929-1934 years witnessed an intensified demand for state old-age pensions (means-tested welfare).[2] Prior to the Depression, old-age pension laws had been enacted in only six states. In each case, relief was funded and administered at the county level, on a county-optional basis. By the end of 1934, old-age pension laws had been enacted in twenty-eight states, Hawaii and Alaska, eighteen of which were county-mandatory. Among the newly created mandatory laws, there was a growing tendency to designate administrative authority to the state, rather than the locality, and for states to contribute

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[1]For two primary works with this viewpoint, that emerged after the onset of the Depression, see Ibid., and Isaac M. Rubinow, The Quest for Security.

[2]For a detailed outline of the date of emergence and major characteristics of state old-age pension laws from 1915-1935, see Table 10. For further discussion, see National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, Inc., 1931), pp. 44-55; Abraham Epstein, Insecurity: A Challenge to America, pp. 532-550; Paul Douglas, Social Security in America, pp. 7-11, and "Congress Faces the Question of Old-Age Pensions," The Congressional Digest, Vol. XIV, No. 3 (Washington, D.C.: A. G. and N. T. Robinson, 1935), pp. 69-72.

partially if not entirely to financing the pension laws. The large majority of plans in operation, however, remained decentralized in the sense that localities funded the programs, set benefit levels, and had some discretion over eligibility requirements.

As the Depression worsened, concern for the elderly poor increased and Congressional attention turned to proposals to aid the elderly with federal funds. Indeed at the same time the material status of the elderly was deteriorating, so was the ability of counties and states to finance relief programs. Between 1931 and 1934, the number of pensioners increased from 70,000 to 231,000, and the yearly cost of the various state old-age pension laws reached $31 million.[1] In some cases, funds for welfare expenditures elapsed entirely. Also, the wide discrepancy in benefit levels and the inaction of a number of states contributed to demands for federal assistance. As shown in Table 13, monthly benefits averaged $20 ($82), ranging from $6 ($24) in Indiana to $29 ($120) in Maryland, and were being paid in counties which accounted for only 40 percent of the total population.[2] It was not until 1934, however, some five years after the onset of the

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[1]See Pual Douglas, Social Security in the U.S., p. 7; and "Congress Faces the Question of Old-Age Pensions," The Congressional Digest, Vol. XIV, No. 3, p. 72.

[2]Paul Douglas, Social Security in the U.S., p. 9.

TABLE 13

OPERATION OF STATE OLD-AGE PENSION LAWS, 1933

State	Year Enacted	Pension Age	No. of Pensioners[a]	% of Pensioners to Persons of Eligible Age[b]	Average Pension[a,c]	Yearly Cost[a,c]
State-Wide Mandatory						
Alaska	1915	65	446	11.1%	$20.82	$ 95,705
Arizona	1933	70	1,974	21.6	9.01	200,927
Cal.	1929	70	19,300	9.2	21.16	3,502,000
Colorado	1933	65	8,705	14.1	8.59	172,481
Deleware	1931	65	1,610	9.7	9.79	188,740
Hawaii	1933	65	(e)	(e)	(e)	(e)
Idaho	1931	65	1,275	5.7	8.85	114,521
Ind.	1933	70	23,418	16.9	6.13	1,254,169
Iowa	1934	65	3,000	1.6	13.50	475,500
Maine	1933	65	(f)	(f)	(f)	(f)
Mass.	1930	70	20,023	12.8	24.35	5,411,723
Mich.	1933	70	2,660	1.8	9.59	306,096
Minn.	1929	70	2,655	2.8	13.20	420,536
Nebr.	1933	65	(g)	(g)	(g)	(g)
N.H.	1931	70	1,423	5.5	19.06	298,722
N.J.	1931	70	10,560	9.4	12.72	1,375,693
N.Y.	1390	70	51,228	13.7	22.16	13,592,080
N. Dak.	1933	68	(h)	(h)	(h)	(h)
Ohio	1933	65	24,000	5.8	13.99	3,000,000
Oregon	1933	70	(i)	(i)	(i)	(i)
Penn.	1933	70	(j)	(j)	(j)	(j)
Wash.	1933	65	2,239	2.2	(e)	(e)
Wyom.	1929	65	643	7.4	10.79	83,231
County Optional						
Kent.	1926	70	(d)	(d)	(d)	(d)
Md.	1927	65	141	.2	29.90	50,217
Mont.	1923	70	1,781	12.4	7.28	155,525
Nevada	1925	65	4,814	.5	15.00	3,320
Utah	1929	65	930	4.1	8.56	95,599
West Va.	1931	65	(d)	(d)	(d)	(d)
Wisc.	1925	70	1,696	1.8	16.75	395,707

TABLE 13--Continued

SOURCES: U.S. Committee on Economic Security, Supplement to Report of the CES, Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess., January 22-February 20, 1935 (Washington, D.C.: Government Printing Office, 1935), pp. 50-51.

"Congress Faces the Question of Old-Age Pensions," The Congressional Digest, Vol. XIV, No. 3 (Washington, D.C.: A. G. and N. T. Robinson, 1935), p. 72.

[a]Figures as of December 31, 1933.

[b]Eligible age as of 1930 Census.

[c]Current dollars. The price level in 1933 was approximately one-fourth the level in 1975.

[d]No pensions being paid.

[e]Information not available.

[f]Not yet in effect.

[g]Lack of funds.

[h]No pensions being paid.

[i]Administered by counties.

[j]Law just put into effect.

Depression, that a bill to provide federal matching funds to states with old-age pension laws made it out of Congressional committee.[1]

Renewed Interest in Social Insurance

Alongside the escalation of the old-age poverty issue was a renewed interest in social insurance. Prior to the Depression, the social insurance movement was effectively dominated by the competition from the more moderate old-age pension movement, yet with the onset of the Depression, the general climate became less hostile toward demands for federalization, and social insurance advocates stood ready to articulate citizens' demands for "security."

By the time the social insurance movement reemerged, important changes in both leadership and direction had taken place.[2] Whereas Isaac Rubinow and John Andrews of the American Association for Labor Legislation (AALL) had been prominent figures in the pre-Depression years, Abraham Epstein of the American Association for Old-Age Security (AAOAS), Paul Douglas, and Eveline Burns emerged as prominent

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[1]For more on the "Dill-Connery" Bill, see Abraham Epstein, Insecurity: A Challenge to America, pp. 533, 546; and Paul Douglas, Social Security in the U.S., pp. 10-11.

[2]Roy Lubove, The Struggle for Social Security: 1900-1935 (Cambridge: Harvard University Press, 1968), pp. 113.

spokesmen during the Depression.[1] Moreover, disputes that had been brewing among the ranks of social insurance advocates during the 1920's were intensified.[2] Specifically, what were the ultimate objectives of social insurance, and therefore, what was the desirable institutional design of such programs? Epstein and Rubinow, radical in their view of the function of social insurance, became increasingly intolerant of the Fraternal Order of Eagles (FOE) and the state old-age pension movement. Since income redistribution was the function of social insurance, as they saw it, county optional pension legislation supported by the FOE represented a serious threat to the viability of more comprehensive redistributive programs.[3]

Epstein, an outspoken advocate of social insurance for redistributive purposes, advocated a break with traditional moral values as embodied in the poor law tradition. Herring on the other hand, who led the movement for welfare programs limited to poverty alleviation, had

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[1]For samples of their work, see in particular, Eveline Burns, Toward Social Security (New York: McGraw Hill, 1936); Paul Douglas, Standards of Unemployment Insurance (Chicago: University of Chicago Press, 1933); and Abraham Epstein, Insecurity: A Challenge to America. Also, see American Association for Old-Age Security, Bulletin, Vols. I-IX, an informative monthly newsletter put out by the AAOAS between June, 1927 and December, 1935.

[2]See Roy Lubove, The Struggle for Social Security, pp. 140-143.

[3]Rubinow said, "the Eagles certainly were successful in putting the legislation through and came very near destroying the entire value of the old-age pension movement . . . for it was the Eagles that were responsible for the 'voluntary' type of legislation." See Isaac Rubinow, The Quest for Security, p. 278.

described the potential pension recipient as, necessarily, "an exceedingly good citizen," with a "history of habitual industriousness, habitual loyalty to family obligations, and freedom from all crimes of more than four months imprisonment."[1] As a result of these fundamental differences, Epstein established the American Association for Old-Age Security in 1927, independent of the FOE and the AALL. The AAOAS took an active role in drafting model, mandatory pension laws, in disseminating information on the merits and successes of abandoning the almshouse, and in supporting the Roosevelt Administration's forthcoming Social Security bill in 1935.[2]

Essentially the same issue ultimately split the ranks of social insurance advocates. When the AALL, the organization that created the social insurance movement in the United States, became active again with the onset of the Depression, Andrews and Commons stressed the need for social insurance for the purpose of preventive insurance, not for income redistribution. Further, they felt that the less identification the movement had with its European counterpart, the better, in light of the bitter defeat of health insurance in 1921. Rubinow and Epstein, on the other hand, felt the time was right to take the existing pension movement and convert it into a full-scale social insurance movement--only with social insurance designed explicitly to redistribute income--

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[1]Frank E. Herring, "We Are On the Fighting Line," The Eagle Magazine (March, 1923), pp. 26-27; cited by Roy Lubove in The Struggle for Social Security, p. 141.

[2]See American Association for Old-Age Security, Bulletin, Vol.s I-IX.

models for which could be found throughout Europe. While there existed an uncompromising split concerning the ultimate purpose of social insurance, most proponents recognized the need to downplay the movement's European conception and counterpart.[1]

The Record of Industrial Insurance During the Depression

The debates that raged over social insurance for prevention versus income redistribution can be put into perspective by examining, in more detail, the experience of industrial pension plans during the Great Depression. Indeed, recognizing the rapid growth and proliferation of private insurance institutions prior to the Depression, did the Depression create legitimate grounds, if not demands, for government old-age insurance for preventive reasons? Did the Depression nullify the early progress?

While it is inconceivable that private insurance markets were immune to the destruction wrought by the Depression, evidence suggests that industrial pensions, the largest source of private pensions covering approximately 4 million workers in 1937, grew steadily during the Depression, had remarkable resiliency and, in fact, their attributes improved markedly.[2] In other words, the private sector, with

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[1]See Roy Lubove, The Struggle for Social Security, pp. 141-143.

[2]National Industrial Conference Board, The Support of the Aged: A Review of Conditions and Proposals (New York: National Industrial Conference Board, 1931), p. 25. For a thorough examination of industrial pension plans up through the Depression, see Murray W. Latimer, Industrial Pension Systems in the United States and Canada, Vol. II

minimal regulation, continued to adapt to changing economic conditions in order to meet the demands for prevention of old-age insecurity. The fact that social insurance proposals, whether advanced as preventive insurance or redistributive maintenance, were designed to be federal and compulsory suggests that income redistribution was at their base.

While the real value of savings and income fell dramatically during the early Depression years, the same period "witnessed an almost unprecedented activity in the establishment of industrial pension systems."[1] Industrial pension systems are of particular interest as they were designed to provide coverage to relatively lower income industrial workers, those for whom alternative means of savings and insurance were relatively costly. Between mid-1929 and the spring of 1932, the rate of establishment of these plans was higher than any other period in history with the exception of the World War I years. By 1935, there were some 750 plans as compared to the 420 that existed in 1930.[2]

(New York: Industrial Relations Counselors, Inc., 1933). To get some feel for the proportion of workers covered by industrial pensions, it was not until after 1950 that the number of OASI beneficiaries exceeded 4 million. See Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, p. 41.

[1]Murray Latimer, Industrial Pension Systems, p. 843.

[2]Paul Douglas, Social Security in the U.S., pp. 245-251. See also, Table 4 in this study for comparative figures on the rate of establishment of new plans between 1874-1929.

The developments in the way of industrial insurance are important since advocates of the forthcoming federal old-age insurance program marketed the federal program as similar to private insurance, but with the added features of safety from depressions, more adequate benefits to which the retired would have contractual claims, and lower service requirements. In fact, industrial pension plans were subject to criticism since most of them stipulated service requirements of up to twenty to twenty-five years, were not completely safe from depressions, and were non-contributory, that is, the worker made no direct premium payments for future annuities. Long service requirements created a residual group of workers who would not be entitled to annuities.[1] In addition, the courts established that workers did not have contractual claims to annuities for which they had made no direct contributions.[2] Finally, the Depression resulted in the highest rate of discontinuance of pension plans than in any preceding period.[3]

Without more careful scrutiny, this evidence would suggest that the private alternative was indeed, "inadequate." It is important to note, however, that developments during the Depression suggest something quite different. Keeping in mind that private pension plans were

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[1]For critical views of private insurance, see Ibid., pp. 245-265; and Epstein on "The Inadequacy of Private Insurance," in Insecurity: A Challenge to America, pp. 116-161.

[2]For a detailed discussion of the contractual obligations of the employer and rights of the employee, see Murray Latimer, Industrial Pension Systems, pp. 681-706.

[3]Ibid., pp. 846-848.

yet relatively new institutions, they proved to be quite resilient. In fact, the 10 percent of the systems that were discontinued, closed to new employees, or suspended involved less than 3 percent of all covered employees; and the large majority of these plans continued benefit payments to current pensioners.[1] During periods associated with long durations of unemployment, it was not infrequent that employers rotated the layoff of workers in order not to break their service requirement. Also, while the courts did deny workers contractual rights to non-contributory pensions, in practice, even failing firms continued to make benefit payments as a matter of course.[2]

The new plans established during the Dperession are most interesting in light of the criticisms directed toward private insurance prior to the enactment of the Social Security law. In contrast to the majority of plans established prior to the Depression, most of the new plans were contributory, and reinsured by private insurance companies. Few established service requirements or compulsory retirement. As contributory plans, workers accrued rights to future annuities with regular vesting of the employee's premiums. In some cases, the employer's contributions were vested as well. In effect then, workers could leave the plan at any time with a paid up annuity. As most of the new plans were reinsured, the likelihood of default was reduced.

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[1] Ibid.

[2] Ibid., pp. 653.

significantly and compulsory retirement was infrequent--the work status of the insured mattered little to the insurance company.[1]

In many ways then private pension plans, which were relatively new in the 1930's were adapting and becoming more flexible; and relative to common stocks and bank deposits, industrial insurance proved to be a "safer" investment. Relative to the monthly benefits that were forthcoming in the original Social Security Act, which ranged from $10-$85, industrial pensions were relatively more "adequate" as well. The average monthly pension in the private sector was $60 ($212) in 1931.[2] Finally, the relative advantages of the emergence of contributory pension plans which bestowed contractual claims to beneficiaries were clearly superior to a compulsory federal program which would do no more than bestow statutory rights to beneficiaries.

The Status of Congressional Legislation: 1934

Just as had been the case prior to the Depression, then, private insurance institutions continued to adapt to changing economic conditions as they affected demands for old-age "security," in an ex ante sense. Also, public welfare institutions were evolving to meet demands for old-age poverty relief, in an ex poste sense. In only twenty years, poverty relief had evolved from indoor relief (the almshouse) at the county level, available with regard to age, to a matter of

[1] Ibid., pp. 850-886.

[2] Paul Douglas, Social Security in the U.S., p. 252.

state-wide concern in which state and local funds were being made available on an outdoor basis to the elderly in most states. In spite of the extent of poverty in the aftermath of the Depression, particularly acute among the elderly, there were still no articulated demands for either a federal program of old-age poverty relief or a federal system of old-age insurance.

This discussion is not intended to suggest that the United States Congress was not seriously considering programs to aid the elderly poor. To the contrary, by 1934, relief for the elderly and the unemployed had become major election year issues. But, the programs being actively considered were moderate in contrast to both those advanced by social insurance advocates during the early 1920's and relative to the forthcoming Social Security program. Indeed, by 1934, rising local old-age relief expenditures and pressure by the AAOAS resulted in very serious attention being given to a federal-state old-age welfare program. In that year, a bill drafted by the AAOAS was introduced into Congress by Senator Clarence Dill (D.-Wash.) and Representative William Connery (D.-Mass.) calling for federal aid to states enacting old-age pension laws. As some indication of the emerging demand-side pressure for federal participating in state old-age welfare activities, the Dill-Connery bill gained unanimous support in both the House Labor Committee and the Senate Finance Committee and represented the "first time in history that a Congressional measure for old-age pension legislation was favorably reported on."[1]

By mid-1934, then, on the eve of President Roosevelt's declaration of policy, the movement for old-age poverty relief on a federal-state matching basis had gained widespread support. Organized labor, social reformers, and the Democratic party had been joined by the Chamber of Commerce and the Republican National Committee in endorsing federal government action for the elderly poor.[2] Depsite the apparently widespread popular support for the Dill-Connery bill, however, Dill and Connery were unable to muster President Roosevelt's sanction for their bill and the seventy-second session of Congress ended before the bill came to vote. Paul Douglas, an active proponent of social insurance in the 1930's, explained Roosevelt's delay as follows:

> There was an undercurrent of feeling among the progressive members of Congress that the President wanted to delay congressional action in order that he might make the program his own . . . The President's desire to combine old-age pensions with a general program of social security and his belief that a unified program should be worked out were, therefore, powerful factors in preventing Congress from passing the Dill-Connery bill.[3]

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[1]See Abraham Epstein, Insecurity: A Challenge to America, pp. 533, 546. See also, American Association for Old-Age Security, Bulletin, Vol. VIII, No. 6, p. 1, 5-6; and Paul Douglas, Social Security in the U.S., pp. 10-11.

[2]American Association for Old-Age Security, "Both Major Parties Promise Social Legislation," Bulletin, Vol. XIII, No. 6, pp. 5-6.

[3]Paul Douglas, Social Security in the U.S., pp. 11, 26.

The broad-based demand for federal assistance for the elderly poor was destined to become a key factor in explaining the rapid enactment of the Social Security Act.

President Roosevelt Takes A Stand: June, 1934

On June 8, 1934, shortly after the demise of the Dill-Connery and Wagner-Lewis bills and only two days after the Republican National Committee endorsed government action for the old and unemployed, President Roosevelt addressed Congress on the general issue of social security. In order to provide "security" to the nation, Roosevelt called for reconstruction measures to create adequate housing and jobs as well as "some safeguards against the misfortunes which cannot be wholly eliminated in this man-made world of ours."[1] Rather than encourage Congress to hasten its examination of current legislation for the poor, aged, and unemployed, Roosevelt announced his intention to establish, by Executive Order, the Committee on Economic Security (CES) to fully explore the question of Social Security during the remainder of the year and report to Congress with a definite program of action in January, 1935. It was evident that Roosevelt intended to take the momentum gained in the last legislative session to propel his own program of Social Security prior to the next general election.

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[1] Charles McKinley and Robert W. Frase: Launching Social Security: A Capture-And-Record Account, 1935-1937 (Madison: The University of Wisconsin Press, 1970), p. 9.

The Creation of the Committee on Economic Security

Members of the CES, who were appointed soon thereafter, included Frances Perkins, Secretary of Labor and first woman cabinet member; Harry Hopkins, Federal Emergency Relief Administrator; H. Morgenthau, Secretary of the Treasury; Homer Cummings, Attorney General; and H. A. Wallace, Secretary of Agriculture; the first being named chairman. The Committee selected Dr. Edwin Witte (Chairman, Department of Economics, University of Wisconsin) as the Executive Director to oversee a research staff; and Second Assistant Secretary of Labor, A. J. Altmeyer, also from Wisconsin, was appointed head of the technical board which was established to design a program of studies and review alternative proposals eminating from a lower level of staff experts. The board consisted of a number of professionals in the federal civil service. Under the chairmanship of Dr. Frank Graham (President, University of North Carolina), a general advisory council was established, comprising "distinguished private citizens" who represented labor, agriculture, universities, charities, etc. Finally, an array of advisory committees were organized in fields such as public health, public employment, and child welfare. Social reformers, progressives, and other advocates of social insurance, who in any real sense constituted early supply-side pressure for social insurance, were well represented on the various councils.[1]

[1]For more on the membership of the CES, see Ibid., pp. 9-10, Paul Douglas, Social Security in the U.S., pp. 26-27; and U.S.

The Report of the Committee on Economic Security

The combined efforts of the various committees culminated with the Report of the CES before Congress, January 15, 1935--the report which led ultimately to the Social Security Act, eight months later. In a cover letter attached to the Report of the CES, President Roosevelt said,

> We pay now for the fearful consequences of economic insecurity and dearly. This plan presents a more equitable and infinitely less expensive means of meeting the costs. We cannot afford to neglect the plain duty before us . . . I strongly recommend action to obtain the objectives sought in this report.[1]

The President's proposals for the elderly, as embodied in the CES report, included three distinct programs.[2] First, a program of federal subsidies to states enacting federally approved old-age pension laws was proposed, similar in most respects to the Dill-Connery

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Committee on Economic Security, Report of the Committee on Economic Security, Hearings before the Committee on Finance on S. 1130, U.S. Senate, 74th Cong., 1st Sess. (January 22-February 20, 1935), Appendix.

[1]Franklin D. Roosevelt, Message from the President Transmitting A Recommendation for Legislation on the Subject of Economic Security, Hearings before the Committee on Finance on S. 1130, U.S. Senate, 74th Cong., 1st Sess. (January 17, 1935), p. 1307.

[2]Along with the three proposed programs for the elderly were proposals for unemployment insurance; and aid to fatherless children, child care services, child and maternal health care services, and public health services. Moreover, they recommended setting up a nationwide system of employment offices; and developing work training programs. See U.S. Committee on Economic Security, Report of the Committee on Economic Security, Hearing before the Committee of Finance on S. 1130, U.S. Senate, 74th Cong., 1st Sess., pp. 1311-1353.

bill. Second, a compulsory federal old-age insurance program for most workers was proposed. The old-age insurance program had no legislative precedents in the United States but was similar in many ways to both the German social insurance program enacted in 1889 and to the types of programs advanced for many years by social insurance advocates.[1] According to the President, the federal subsidies under the first program were designed to provide relief to the currently elderly poor who would not have had an opportunity to contribute to the insurance program. As such, the non-contributory old-age pension program was intended to be strictly temporary, and in the President's words, "ultimately to be supplanted by self-supporting annuities."[2] Finally, a third program was proposed, a voluntary annuities program, to provide old-age insurance to those persons who would not be covered by the compulsory program and to those who wished to supplement their government benefits.

Since the comprehensive array of proposals embodied in the CES report were passed, with few major modifications, only eight months

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[1]A legal precedent for compulsory old-age insurance was the enactment of the Sterling-Lehlbach Act of 1920. The Act established a retirement system for federal civil service employees, then numbering 300,000. This was a contributory plan originally financed by a 2 1/2 percent salary deduction. Federal appropriations were added after 1929. Numerous municipal plans were also in existency by this time covering, most notably, teachers, firemen, and policemen. See Roy Lubove, The Struggle for Social Security, pp. 126, 241.

[2]Message from the President, Hearing before the Committee on Finance on S. 1130, p. 1307.

later in the original Social Security Act, those relating to provisions for the elderly are described in some detail below.

Non-Contributory Old-Age Pensions (Means-Tested Welfare for the Elderly Poor)

In order to encourage the twenty states without pension laws to adopt legislation and to encourage the other states to liberalize their laws, the CES recommended a system of federal subsidies to states with federally approved pension programs.[1] The subsidy was recommended to be 50 percent of each state's expenditures on pensions up to a maximum federal payment of $15 ($59) per month, plus 5 percent of the state's administrative costs.

The following conditions were recommended as stipulations on the state laws:

(1) The law had to be state-wide and mandatory.

(2) A state welfare authority had to be designated which would be responsible to the federal government.

(3) There had to be established a minimum pension that would have provided the pensioner with a "reasonable subsistence."

(4) Every person had to be eligible for a state pension if he had satisfied the following conditions:

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[1]For the details of the three plans for the elderly, see U.S. Committee on Economic Security, Report of the Committee on Economic Security, Hearings before the Committee on Finance on S. 1130, pp. 1330-1339; and Paul Douglas, Social Security in the United States, pp. 151-184.

(a) 65 years of age.

(b) United States citizen.

(c) State resident for at least five years out of the preceding ten years.

(d) Not an inmate of an institution.

(e) Had property valued at less than $5,000 ($19,500).

(5) The federal pension would have constituted a lien upon the pensioner's estate which, upon his death, was to be collected by the state and refunded to the federal government.

Finally, the Committee urged,

> It is essential that as soon as possible these persons be brought into the compulsory system of contributory annuities, else the annual government contributions will be so high as to constitute an impossible charge on the taxpayer.[1]

Compulsory Contributory Annuities
(Old-Age Insurance)

To supplement and eventually supplant the non-contributory pension system, a compulsory contributory annuities program was recommended. The outline of their plan was as follows.[2]

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[1]U.S. Committee on Economic Security, Report of the Committee on Economic Security, p. 1334.

[2]See Ibid., pp. 1334-1338.

Coverage--Every manual and nonmanual worker, excluding government employees and persons covered by the Railroad Retirement Act, earning less than $250 ($980) per month was to be covered by the program.

Tax--The program was to be financed by a payroll tax imposed equally on the covered employee and his employer, effective January 1, 1937. To keep the reserve within "manageable limits," the CES suggested a combined tax rate, shown in Table 14, of 1 percent for the first five years the program was in operation, rising to a maximum of 5 percent in 1957.[1] The tax was to be applied on incomes up to $150 ($600) per month.

Benefits--No benefits were to be paid until the program had been in operation (collecting taxes) for five years. Individuals were to qualify for old-age benefits if they were at least 65 years of age, had retired completely from gainful employment, and had paid taxes for at least 200 weeks. If the worker died before attaining the age of 65, or before receiving in benefits the amount he had contributed, his dependents were to be entitled to the difference between his contributions and what he received, plus 3 percent interest. Covered individuals who did not become eligible for benefits, by contributing for less than 200 weeks, were to have refunded their own contributions

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[1]Ibid., p. 1335.

TABLE 14

THE CES'S PROPOSED PAYROLL TAX RATE SCHEDULE

Year	Combined Tax Rate
1937-1941	1%
1942-1946	2%
1947-1951	3%
1952-1956	4%
1957 and thereafter	5%

SOURCE: U.S. Committee on Economic Security, Report of the Committee on Eoncomic Security, Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess. (1935), p. 1335.

plus 3 percent interest. "In all cases . . . members shall not receive less than the actuarial equivalent of their own [italics mine] contributions."[1]

The CES proposed higher benefits for persons entering the system in 1937, already middle aged or older, as they would have been unable to contribute amounts necessary to receive "adequate" benefits on an actuarial basis. Table 15 and 16 present the Committee's proposed benefits for early entrants.

In contrast to the above benefit schedule which provided unearned benefits for early entrants, the CES recommended lower annuities for persons entering the system after 1942. The benefit rate for a person who began paying taxes in 1942 or thereafter, was recommended to be only 10 percent of his average monthly wage plus 1 percent for each forty contributing weeks in excess of the 200 week minimum. The proposed benefit schedule is illustrated in Table 17.

As can be seen by comparing Tables 15 and 17, anyone covered by the program in 1937 who was already older than thirty was to receive benefits in excess of what the program would offer when in full operation. These were the persons who would receive "unearned benefits." As such, a person who worked for thirty-five years or less in covered employment earned a lower annuity simply by entering the system in 1942 rather than 1937. In fact, late entrants would receive a lower rate of

[1]Ibid., p. 1336.

TABLE 15

PROPOSED BENEFITS FOR PERSONS ENTERING THE SYSTEM IN 1937

Year of Retirement	Monthly Pension
1942	15% AWW[a]
1943-1947	16% AWW - 20% AWW, rate rising 1%/yr
1948-1957	22% AWW - 40% AWW, rate rising 2%/yr
1957 and thereafter	40% AWW, maximum benefit payable

SOURCE: U.S. Committee on Economic Security, Report of the Committee on Economic Security, Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess. (1935), p. 1335.

[a]AWW = average weekly wage up to $37.50/week, where $2,000 was the maximum taxable yearly earnings.

TABLE 16

ILLUSTRATION OF PROPOSED BENEFITS FOR PERSONS ENTERING THE SYSTEM IN 1937[a]
(Current Dollars)[b]

Age in 1937	Yrs Contributed to the System	Date Benefits Payable	Average Monthly Earnings $50	$100	$150-250 (max)
60	5	1942	$ 7.50	$15.00	$22.50
55	10	1947	$10.00	$20.00	$30.00
50	15	1952	$15.00	$30.00	$45.00
45	20	1957	$20.00	$40.00	$60.00
40	25	1962	$20.00	$40.00	$60.00
30	35	1972	$20.00	$40.00	$60.00
20	45	1982	$20.00	$40.00	$60.00

[a]Calculated on the basis of information contained in: U.S. Committee on Economic Security, Report of the Committee on Economic Security, Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess. (1935), p. 1335.

[b]In order to convert these figures into 1975 dollars, multiply by four.

TABLE 17

ILLUSTRATION OF PROPOSED BENEFITS FOR PERSONS ENTERING THE SYSTEM IN 1942 AND THEREAFTER[a]
(Current Dollars)

Age in 1937	Yrs Contributed to the System	Date Benefits Payable	Average Monthly Earnings		
			$50	$100	$150-250 (max)
60	5	1947	$ 5.50	$11.00	$16.50
50	15	1957	$10.50	$21.00	$31.50
40	25	1967	$15.50	$31.00	$46.50
30	35	1977	$20.50	$41.00	$61.50
20	45	1987	$25.50	$51.00	$76.50

[a]Calculated on the basis of the benefit formula proposed by the CES in: Report of the CES, Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess. (1935), p. 1336.

return not only because of the lower benefits payable but also because they would be subject to higher tax rates over their working lives.

As formulated, then, the compulsory old-age annuity system would have provided benefits to the group of individuals who at that time were middle-aged and older well in excess of their contributions. The CES estimated that the cost of unearned benefits, if paid by the federal government, would total approximately $500 million ($1.9 billion) per year. The Committee recommended, therefore, that the federal government make no contribution until 1965 on the grounds that it would prevent an excessively large reserve (about $75 billion) and remove the "unfair" burden on the younger generation who would not only have had to pay for their own annuities, but also for older entrants' unearned annuities.[1] The CES recognized that the "creation of this debt will inpose a burden on future generations," but decided there were more pressing considerations.[2]

Voluntary Old-Age Annuities

To supplement the compulsory old-age insurance program, a system of voluntary old-age annuities was recommended in order to provide persons not covered by the compulsory program the opportunity to

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[1]It is interesting to note that expenditures on OASDHI alone exceeded $75 billion in 1974. See Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, pp. 61-63.

[2]U.S. Committee on Economic Security, Report of the Committee on Economic Security, p. 1337.

purchase "annuities similar to those issued by commercial insurance companies" in a "systematic and safe" way.[1] Further, these annuities would have been available as a means to supplement voluntarily the compulsory program. The following recommendations were made:

(1) The plan was to be self-supporting, and administered by the Social Insurance Board, part of the Department of Labor.

(2) The terms of the plan were to be simple, offering, say, only a few types of standard annuities.

(3) Premiums and annuities were to be kept small, say, $1 monthly premiums with a maximum monthly pension of $50.

Thus, the CES recommended a voluntary program designed "primarily for the same economic groups as those covered by the compulsory system."[2] Further, they suggested, "study will be necessary, however, before a practical method of accomplishing this purpose can be suggested, one which will avoid the danger of benefitting those persons who need assistance least."[3]

These three programs for the elderly were included in the Committee's Report of January 15, 1935, along with proposals for a tax-offset system of unemployement compensation; and federal grants to

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[1] Ibid., p. 1338.

[2] Ibid., p. 1338.

[3] Ibid., p. 1339.

states for mothers' pensions, care for dependent and crippled children, and public health programs. The Report, which embodied President Roosevelt's suggestions, was detailed and introduced into Congress two days later as the Economic Security Bill.

Alternatives to the Administration's Report: An Indication of the Political Climate?

The Committee's Report, in its entirity, represented a comprehensive and radical plan to quickly alleviate, through subsidized assistance programs, the poverty reaked by the Depression, and set up longer run annuities and unemployment insurance programs. Moreover, the recommendations would have established an unprecedented role for the federal government in a traditionally state or private domain.

In response to the Report, heated debates ensued between conservatives who believed the federal government was proposing to overstep its proper limited role and liberals who advocated more extensive federal programs, yet the Economic Security Bill made its way through Congress largely unscathed in only eight months.

With regard to the old-age provisions of the Report, it is not difficult to explain the eventual success of a temporary subsidy program to improve relief provision at the state level, as the Depression had left many elderly persons without support and some states without the funds to continue pension payments. Further, there had been a growing demand for just the type of subsidy program outlined in the Report. An explanation of the acceptance and establishment of a permanent, compulsory old-age insurance program is less obvious given that private savings and insurance institutions had been so prosperous prior to the Depression. Advocates reminded opponents of the potentially higher rates of return in the public sector, lower administrative costs, the possibility of unearned benefits to the near-elderly, and "guaranteed" benefits to all persons under the system; yet the sheer logic of these arguments, independent of the current economic debacle, or independent of seriously considered alternative proposals is not, and was not, persuasive.

Importantly, the 1929-1933 depression phenomena was at best poorly understood, and proposed remedies were diverse. It is interesting to note that the recommended economic security program was advanced as not only a remedy for the effects of the Depression, but also a means of preventing another. To quote Roosevelt,

> The establishment of a sound means toward a greater economic security of the American people is dictated by a prudent consideration of the hazards involved in our national life. No one can guarantee this country against the dangers of future depressions, but we can reduce these dangers. We can eliminate many of the factors that cause economic depressions, and we can provide the means of mitigating their results. This plan for economic security is at once a measure of prevention [italics mine] and a method of alleviation.[1]

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[1] Message From the President, Hearings before the Committee on Finance on S. 1130, p. 1307. Also, the CES said, "The CES in its recommendations places first the matter of employment assurance, . . . the stimulation of private employment and the provision of public employment." Hearings before the Senate Finance Committee on S. 1130, 74th Cong., 1st Sess. (1935), p. 32.

The New Deal government provided hope to the people. Many people had been made aware of the fallibility of private savings institutions in protecting investments during a depression. And, after all, the President's proposals were designed to create a government "insurance" program similar in many ways to private insurance plans. Combined tax rates to finance the annuities were not scheduled to exceed 5 percent. A fund was intended to be built up similar to that of private insurance companies and benefits were to be paid as increasing functions of contributions, only the government could "guarantee" benefits--not only that benefits were forthcoming, but also that they would exceed contributions by a positive interest rate factor. Only some were aware of the difference between contractual rights, as in the private sector, and statutory rights, as in the public sector. Only a few were aware of the mounting costs associated with previously tried government retirement schemes--the political pressures to expand benefits and liberalize coverage.[1] For a great many, traditional values of thrift, individual responsibility, and liberty could be set aside after the Depression.

And, what were the alternatives to the Administration's proposals with regard to the elderly? Since there had been no previous proposals for compulsory old-age insurance in Congress and, therefore,

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[1]Experience with Civil War Pensions and the federal civil service retirement program were two such examples.

little incentive to draft more moderate counter-proposals, the only real alternatives to the Economic Security Bill were more radical. Of the various proposals for more radical action, the two that gained the most attention were Huey Long's proposal to "Share-Our-Wealth" and Dr. Francis Townsend's plan to provide non-contributory monthly pensions to everyone over sixty.

The "Share-Our-Wealth" Society.

Senator Huey Long (D.-La.), popularly known as the dictator of Louisiana, was one of the keenest supporters of radical income redistribution. As early as the spring of 1933, Senator Long proposed a 100 percent federal tax on all annual incomes exceeding $5 million ($20.5 million), and property valued at more than $50 million ($205 million). The bill was advanced, according to Long, simply as a means of putting into action what Roosevelt had demanded at the Presidential Convention, June, 1932, when he announced his intentions to give the American people the opportunity to "share in the redistribtion of wealth."[1] On March 12, 1933, the Senate rejected his plan to "Share-Our-Wealth" by a vote of 54-18.[2]

[1]Cong. Rec. (June 22, 1935), p. 9908.

[2]For more on Long and the "Share-Out-Wealth" Society, see The Congressional Digest, Vol. XIV, No. 3 (1935), p. 79; Arthur M. Schlesinger, The New Deal in Action (New York: The Macmillan Co., 1940), pp. 36-37; and Cong. Rec. (June 22, 1935), pp. 9906-9911, and (June 24, 1934), p. 9928.

As the Social Security movement sprang to life in 1934-1935, Senator Long repeatedly proposed his scheme to share the wealth. By this time, it had taken new form. The proceeds of the federal tax on incomes, inheritances and property were to be distributed to everyone over sixty, with annual incomes less than $1,000 ($4,100) and property valued at less than $10,000 ($41,000) in the form of $30 ($123) monthly pensions.[1] Long, and his left-wing support, pleaded with Roosevelt to assert his power as the chief executive and implement such explicit measures to redistribute income.[2]

Strength was added to the "Share-Our-Wealth Society" when on March 5, 1934, Roosevelt announced, in a speech to the National Recovery Administration, his plans to undertake measures

> . . . by lawful, constitutional processes to reorganize a disintegrating system of production and exchange . . . The reorganization must be permanent for all the rest of our lives in that never again will we permit the social condition in which we allowed the vast section of our population to exist in an un-American way, which allowed a maldistribution of wealth and power.[3]

In June, 1935, Roosevelt addressed Congress with a proposed tax plan which included increased taxes on inheritances, gifts, large personal incomes and net corporate income. It was generally believed that this plan in conjunction with the Economic Security Bill was a

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[1] The Congressional Digest, Vol. XIV, No. 3 (1935), p. 79.

[2] Cong. Rec. (June 22, 1935), p. 9906.

[3] Speech delivered March 5, 1934 at a meeting of the NRA, cited in Cong. Rec. (June 22, 1935), p. 9906.

defensive political move on Roosevelt's part to capture, prior to the 1936 election, the developing left-wing support behind Senator Long and Dr. Townsend.[1] It is difficult, of course, to assess Long's impact; but, by filibustering, Long was at least effective in significantly reducing the new Social Security Board's planned appropriations.[2]

The Townsend Movement

The Townsend movement was larger and better organized than Long's Society, but was no less radical. Dr. Townsend, a retired physician from Los Angeles, gained attention in 1933 when he circulated a petition to Congress proposing monthly pension payments of $200 ($830) to all persons older than sixty, whether married or single, rich or poor, to be financed by a transactions tax.[3]

Within two years, his movement, which was described as having "many attributes of a religious cause," had mustered nearly 3.5 million paid supporters. Townsend Clubs sprang up at the rate of 100

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[1]In an article in the New York Times, it was said that "he [President Roosevelt] hopes to cut into the political forces behind Huey Long and Dr. Townsend by means of his own more rational proposals. They may not be financially sound, or capable of realization, but politically they ought to serve very well in 1936." Cited in Cong. Rec. (June 22, 1935), p. 9907.

[2]This is discussed more fully in Chapter IV, pp.

[3]For discussion of the Townsend Plan, see, in particular, The Committee on Old-Age Security, The Townsend Crusade (Washington, D.C.: Twentieth Century Fund, Inc., 1936); "Is the Townsend Plan for 'Old-Age Revolving Pensions' Sound?" The Congressional Digest, Vol. XIV, No. 3 (1935), pp. 92-94, and 79; Paul Douglas, Social Security in the U.S., pp. 69-74; and Arthur M. Schlesinger, New Deal in Action, pp. 36-37.

per week, reaching 7,000 in 1935; and the Townsend National Weekly reached a peak circulation of 2 million.[1] As one opponent said,

> No proposal put before the American people in recent years has had so widespread an emotional appeal nor has so quickly enlisted vast multitudes of devoted followers as has the Townsend plan.[2]

Townsend's first bill was introduced by Representative McGroarty, January 16, 1935, the day after the CES made its report. The bill proposed $200 ($708) monthly pensions to every person over sixty, the only stipulation being that the recipient would have had to quit work and spend the entire check within the month received. The plan was to be financed by a 2 percent tax on the gross value of all transactions (wages and salaries exempt).[3]

In response to criticism that the tax would not have been sufficient to support the program, a second bill was introduced by McGroarty on April 1, 1935; this time as a substitute bill to the old-age provisions of the Economic Security bill. The Old-Age Revolving Pension Plan proposed a 2 percent tax on transactions, a 2 percent tax on all inherited property, and a 2 percent tax on all gifts larger than $500 ($1,960). In this version, benefits were to be payable only to persons with annual incomes less than $2,400 ($9,360), the level of which would be set to meet revenues.[4]

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[1] Committee on Old-Age Security, The Townsend Crusade, pp. 7-10.

[2] Ibid., p. 5.

[3] Ibid., pp. 7-10.

[4] Ibid.

The logic of Townsend's plan was simple, he said. "It was folly to practice economy in a world of abundance," and his scheme was devised not only to make older people better off, but also everyone else--it was, he conjectured, a means to get the economy out of depression.[1] Townsend reasoned that by distributing tax receipts back to the elderly and by requiring them to spend them, the demand for goods and services would increase immediately, thus stimulating business, employment and prices. Townsend added that rising prices were a sign of prosperity and further, that if there were a trade-off, inflation was preferable to unemployment--"what benefit is there to an unemployed man in low prices if he doesn't have the money with which to buy?"[2]

In response to questions raised concerning why the pensions were so large, Townsend responded,

> . . . because to cut it in two would be to cut its economic benefits in two. Please understand this; the persons more than sixty who receive pensions will be performing a task and a duty when they spend their pensions. The chief purpose is to get someone to spend money, to increase the buying power of the nation. The more that is put into circulation, the better off we will be as a nation.[3]

Finally, Townsend figured that his plan would release 4 million jobs, previously held by the elderly, to the unemployed.

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[1]Ibid., p. 7.

[2]"Is the Townsend Plan Sound?" Congressional Digest, Vol. XIV, No. 3, p. 93.

[3]Ibid.

Critics of the Townsend plan, including most prominently members and allies of the CES, produced mountains of figures on the cost of the program. They estimated that the plan would have made benefits payable to 85 percent of the persons over sixty, or nearly 10 million people, at a cost of $24-$25 billion annually. This figure represented one-half of national income in 1934 and nearly two times the total tax revenues of all levels of government in 1932.[1] One critic responded,

> This amounts to saying that if there are fewer persons working and those who do not work would spend more, the country would be richer . . . If there were any truth whatever in the theory that a nation can become prosperous by not producing, then the Depression itself should have made us roaring rich.[2]

Perhaps more pointedly, Walter Lippmann concluded:

> Dr. Townsend is, in my opinion, a public benefactor. He has succeeded in inventing a conundrum which reduces to absurdity a whole mass of ideas that have had great vogue during the Depression. Some of these ideas are current in forms which make it harder to detect the catch than it is in Dr. Townsend's scheme. They all, however, derive from the same notion, which is that if people worked less and spent more, they would be richer.[3]

Regardless of possible current economic critiques of the Townsend plan and its radical nature, the movement gained national

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[1]See statements by Edwin Witte, executive director of the CES, and Walter Lippmann in <u>The Congressional Digest</u>, Vol. XIV, No. 3 (1935), pp. 92, 94.

[2]Statement by Walter Lippmann; see Ibid., p. 93.

[3]Ibid.

attention, and it is this latter fact that merits attention.[1] The fact that the movement gained such avid popular support among the elderly helps put the Great Depression and the success of the New Deal in perspective. As recently as 1933, no bills for old-age pension legislation had ever been reported out of committee; and the one reported in 1934 (Dill-Connery bill) was not acted upon. From the individualistic environment of the pre-Depression period, opposed to federal government intervention in the realm of social welfare measures, the enviornment had changed to one in which Congress was not only seriously considering proposals that would have expanded dramatically the role of the federal government, but also was entertaining more radical proposals.

Did the emerging support for radical redistribution programs represent a change in values on the part of citizens? Had individualism been abandoned for collectivization? In all probability, the answer to both questions is no. More likely, the success of the Townsend movement was "some measure of the desperation felt by the old people."[2] Also, it

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[1]As some measure of its national attention, a Gallup poll taken as late as 1939 indicated that 95 percent of the people surveyed knew of the Townsend Plan, 40 percent favored it, and as many as 49 percent knew the exact amount of the proposed monthly pension. See Michael Schiltz, Public Attitudes Toward Social Security: 1935-1965, U.S. Department of Health, Education, and Welfare, Office of Research and Statistics, Report No. 33 (Washington, D.C.: Government Printing Office, 1970), p. 42.

[2]Thomas Eliot, "The Story of the Social Security Act," seminar presented at Tulane University (March 17, 1977).

may represent some measure of the extent to which the New Deal government made clear the inherent redistributive nature of the political process. As the redistributive potential of the federal government became widely recognized, the elderly emerged as a prominent special interest group no longer content with earned benefits when there existed the potential for gratuitous transfers.

The immediate effect of both the Townsend and the Long movements was to smooth the way for the Social Security Act which in contrast appeared more moderate.[1] As the economic climate improved, however, removing the element of urgency so helpful to New Deal legislation, the major impact of radical opposition was on the Social Security Board's first years in operation, by narrowing public support and making funding more difficult.[2] It is interesting to note that the Townsend plan gained momentum throughout 1935, and remained a threat to the viability of the Social Security program for four years after the President signed the Social Security Act in August.

The Lack of Effective Opposition to the Economic Security Bill--An Alternative Explanation

Of what significance is the fact that conservatives and other opponents of social insurance could exert no effective opposition to

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[1]For just this reason, it was certainly rational on the part of social insurance advocates to overstate the success of radical proposals.

[2]This point is developed in Chapter IV.

the Economic Security bill, and that the bill was passed largely in its entirety? Can these facts, along with the fact that the only serious alternatives to the bill were more radical, be taken as evidence that a majority of citizen-voters supported old-age insurance, unemployment insurance, and a whole series of federal-state welfare programs? It would be at once too easy and too unsatisfying to assert that despite the fact that no bills had ever been introduced into Congress for old-age insurance that the enactment of the Social Security Act only eight months later reflected broad-based citizen demands for old-age insurance. Alternatively, simply reflecting on a large number of votes that were ultimately cast for the bill cannot provide answers to these questions unless it is clearly established that the Congressional decision-making process was competitive.

Indeed, it is important to examine in more detail both the Congressional decision-making process in 1935 and the motivations of its participants. Specifically, can the collective decision-making process be best described as perfectly competitive thus insuring that the final Act was constrained to reflect broad-based citizen demands? Or, might the process be described more aptly by a monopolistic model in which supply-side agents, including politicians, bureaucrats, and potential bureaucrats, played a disproportionate role in the timing and form of the Social Security Act.

In attempting to answer these questions, one should keep in mind that President Roosevelt superceded Congress in establishing the

CES by Executive Order. As such, the Committee and its staff were independent of Congress in drafting proposed legislation. Moreover, they were staffed by top level cabinet members, bureaucrats, and other social insurance advocates--those persons with vested interests in advancing programs with specific institutional features. While there were many ways that emerging demands for old-age "security" may have been satisfied, ranging from temporary federal-state welfare programs to subsidized or insured private insurance companies, social insurance advocates chose to advance a compulsory, federal, old-age insurance program along with an entire array of federal-state welfare palns.

Of what significance is this? Indeed, if the CES was simply one of many competing suppliers of proposals, there would be little significance to who drafted the bill. It is suggested, however, that the creation, staffing, and funding of the CES with the purpose of formulating a Social Security program secured for the Committee unusual "market power" in determining the outcome of the collective choice process. In any real sense, the CES and other advocates effectively dominated the information presented Congress and the public, and as a result, had particular control over the legislative process, and were able to "profit" from tying a number of seemingly unrelated programs into a single legislative bill.

Information Control

The social insurance advocates' source of power--control over information--was simply an outgrowth of the fact that they had very clear incentive not only to gather information, but also to take an active role in disseminating it. For years before the Depression, social insurance advocates had studied the early European social insurance schemes. As advocates and high demanders of "social justice," their endeavors rarely included studies of the functioning and relative advantages of American savings and insurance institutions.

The question arises, of course, why weren't conservatives, business interests, and in particular, insurance companies, just as effective in offering competing sources of information? First, since social insurance was not seriously considered before 1934, there would have been little incentive for opponents to invest in acquiring and disseminating counter-information. For the same reason, it is unlikely that there were any well established Congressional committees to oversee such studies. Perhaps the most important factors, however, are those that an economic theory of lobbying might explain--the underinvestment of resources in lobbying for or against government programs for which the benefits are shared collectively. The direct costs of lobbying to, say, an insurance company included the time and effort involved in accumulating and disseminating information (in lobbying), in drafting legislation, as well as the "psychic" costs of representing self-interested capitalists during the era named "the highwater mark of radicalism." And, what were the benefits? Importantly, there were no direct benefits to the insurance company, or to the conservative Congressman, that would not have been shared equally with all other insurance companies or Congressmen. Effectively blocking the compulsory old-age insurance program would have secured benefits for all companies whether or not they had participated in sharing the costs. The familiar public goods problem was present and we could have predicted an underinvestment in lobbying against Social Security.[1]

How did this differ from the lobbying activities of social insurance advocates, as surely there were direct costs to the individual and the benefits of a social insurance program would have been shared collectively? The important difference is that social insurance advocates could expect large direct benefits to their lobbying activites.[2] Unlike the insurance company, there were benefits to the individual

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[1]In fact, among fiscal conservatives, there existed a far less organized movement against Social Security and the New Deal. One such organization, however, was the American Liberty League founded August, 1934, to "combat radicalism, preserve property rights and uphold and preserve the Constitution." Financed by wealthy industrialists, especially the DuPonts, the League attacked the Administration's program through publicity, spending more than $900,000 ($3.5 million) in 1935 and 1936. Further, the League attempted to elicit Democratic support with two former presidential nominees, John Davis and Alfred E. Smith, who sat on its Board of Directors. Most tangible of the League's activities was the establishment of a committee of coprorate lawyers funded to pass judgment on the constitutionality of Roosevelt's programs before they went to court.

See Arthur Schlesinger, <u>The New Deal in Action,</u> pp. 37-38.

[2]For a discussion of the calculus of lobbying, see Peter Aaranson and Peter Ordeshook, "A Prolegomenon to the Theory of the Failure of Representative Democracy," (Mimeographed, Carnegie-Mellon University, 1976). For a similar model of participation, see Gordon Tullock, "The Paradox of Revolution," <u>Public Choice</u> XI (Fall, 1971):81-99; and Richard Auster, "The GPITPC and Institutional Entropy," <u>Public Choice</u> XIX (Fall, 1974):77-83.

alone that were contingent upon his "lobbying," or exhibiting active support for Social Security: a job in the newly created bureaucracy, a staff position in Congress, an expanded realm for an existing agency, jobs for students and colleagues, consulting, research and data possibilities. In addition, many advocates were currently employed in the types of employment that facilitated, if not funded, research in support of government programs (government bureaus, social work, universities), thus reducing the direct costs to the individual of lobbying.

In essence, then, even if the CES had not been created to supersede Congress, and had not presented Congress with a complex tied package of institutions, we could have predicted that competing sources of information would have been outweighed by the information made available by supporters of the old-age insurance program. This discussion is not intended to suggest that the features of the old-age insurance program were unconstrained or without support. To the contrary, the program was limited in scope relative to both the early proposals advanced by advocates and to the Social Security program in the 1970's. Also, the old-age insurance program "promised" a positive rate of return on workers' tax payments. What is suggested, however, is simply that more limited programs could have mustered political support as well and that there is little reason to expect that an old-age insurance program modeled after Germany's would have emerged from Congress had it not been presented to Congress by the CES.

Agenda Control: Tie-In Sales and All-Or-Nothing Offers

Another way of viewing this phenomena of bureaucratic power through information control is to examine its impact on the agenda process in Congress. That is, is it possible to have a competitive agenda-formation process in the presence of information control? Alternatively, is it reasonable to expect competitive outcomes to a voting process in which the agenda is controlled? Indeed, an important ingredient of democratic models of the collective choice process is the existence of a competitive agenda process, or one which might be described by the following conditions: (1) anyone can put forth a motion to be voted upon; (2) each motion put forward is voted upon; and (3) it is costless to put forward a motion.[1] If so characterized, the agenda process could be expected to generate market-like information on alternative price-output bundles; and indeed, it is the information generated in markets and disseminated through prices that underlies the competitive process.

In essence, one can liken this idealized process to a private sector analogue in which there exists a "market" for items on the agenda, with many producers competing in the supply of motions. In a second stage, the voting rule would be applied through which buyers or

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[1]For more on this, see Duncan Black, The Theory of Committees and Elections (Cambridge: Cambridge University Press, 1958); and Arthur Denzau and Robert Mackay, "Benefit and Tax Share Discrimination by Monopoly Bureaus," (Mimeographed, Tulane University, 1976).

voter-demanders would express their preferences among motions. If it is only the voting process per se (in which motions are paired and voted upon) which is competitive, there is no assurance that the winning motion will best reflect the demands of the citizenry; only that it will best reflect the demands among predetermined alternatives. The process of agenda-formation is thus key to competitive outcomes in the public sector.

When this competitive or democratic model is extended to make predictions about the formation of the agenda in 1935 with costly and imperfect information, it is evident that the CES was one supplier with significant "market power." The CES was federally subsidized to operate in the agenda market--to produce a bill--and the dissemination of information on the bill, with the aid of President Roosevelt, was federally subsidized as well. These subsidies produced a type of market power that could not be eroded by the existence of competing suppliers. Once the CES's Report was on the agenda, reasonable counter-proposals were costly to submit in both time and dollar outlays, and in many cases, the costs would have been born directly by participants rather than diffused through taxpayer support. Also, as suggested earlier, the creation of a counter-proposal to the CES report would have been analogous to the production of a public good in that the benefits to advocates of counter-proposals would have been shared collectively while the costs need not have been. Thus, the CES's power via subsidized information was compounded with the general and pervasive problem of an undersupply of motions per se.

Once one recognizes the particularly favorable position of the CES, it is but a simple step to explain not only why they combined an unprecedented old-age insurance program with old-age welfare in a single bill, but also why so many other seemingly unrelated social programs were included as well. Specifically, they were employing familiar monopolistic sohemes, including the tie-in sale and all-or-nothing offer, to exploit their discretionary position.[1] The tie-in sale, in this context, was the exchange of a Congressman's vote for a bundle of programs. The Report tied the creation of old-age welfare to the acceptance of old-age insurance. The first program had widespread and bipartisan support which had been developing for some ten to fifteen years and was nearing enactment during the previous legislative session. The federal government was in a particularly strong position as a single seller of public funds for welfare as there existed few good alternative suppliers five years after the onset of the Depression. This was clearly not the case with old-age insurance, for which there were many alternative suppliers. By tying the programs, the

[1]For a discussion and analysis of the use of monopoly practices by bureaus, see Richard E. Wagner and Warren E. Weber, "Competition, Monopoly, and the Organization of Government in Metropolitan Areas," Journal of Law and Economics (December, 1975):661-684; Thomas Romer and Howard Rosenthal, "Bureaucrats vs. Voters," (Mimeographed, Carnegie-Mellon University, 1976); Arthur Denzau and Robert Mackay, "Benefit and Tax Share Discrimination by Monopoly Bureaus," (Mimeographed, Tulane University, 1976); and William Niskanan, Bureaucracy and Representative Government.

Administration eliminated a constraint on government behavior.[1] Rather than simply registering opposition to old-age insurance by voting against it, Congressmen had to weigh the losses associated with its enactment against the gains associated with the enactment of old-age welfare. The political support for old-age welfare could then be employed to offset opposition to old-age insurance. Moreover, by increasing the number of politically appealing welfare programs (aid to mothers, the blind, orphans, etc.) tied to old-age insurance, the likelihood of swinging opposition votes was increased dramatically.[2]

The ability of the CES to effectively utilize the tie-in sale or bundle of programs and not face "debundling" proposals lay in the power of an all-or-nothing offer. An all-or-nothing offer, in this context, was the implicit exchange of a Congressman's vote for all items in the bundle or none at all. In this case, it would have been rational for a Congressman to support the entire package as long as he would have been better off than with none of the programs at all.

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[1] For this view of the tie-in sale, see Wagner and Weber, "Competition, Monopoly, and the Organization of Government in Metropolitan Areas," Journal of Law and Economics (December, 1975):661-684.

[2] Thomas Eliot, principal draftsman of the Social Security Act, said that his greatest contribution was making Title I of the Act old-age assistance (welfare), and "buying" old-age insurance in Titles II and VIII. He admitted that old-age insurance was so unpopular that if it were not drafted that way, "no one would have kept on reading." Thomas Eliot, "The Coming of the Social Security Act," seminar presented at Tulane University (March 17, 1977).

Roosevelt had made it clear that the old-age insurance portion of the bill was the heart of the Social Security program and that the indiscriminate extension of welfare without a longer run annuities program would have been unacceptable. At a minimum, federal welfare funds may have been slow to materialize. In light of this, it is remarkable and indeed a reflection of the intense opposition to old-age insurance, that a vote to eliminate the old-age insurance titles completely mustered 30 percent of the votes cast in the House of Representatives.[1]

The following quote by Abraham Epstein, an outspoken and long time leader of the social insurance movement, reflects most clearly the powerful position of the Administration in determining the final outcome, as well as the degree to which this power was a bipartisan issue:

> There was an insistence from the beginning that the bill be jammed through Congress in its omnibus shape. This presented a real dilemma to earnest members of Congress genuinely interested in bringing about social security. They could not physically find the time to master the details of the many subjects involved in the bill. Nor could they place themselves in the same category with the anti-social members of Congress in opposing the entire bill. As a result, although many Congressmen were fully conscious that the bill embodied economic fallacies, many social dangers, and constitutional difficulties in many phases, there was a general conviction that the subsidies set up for old-age pensions, mother's aid, the blind, etc., for which the AASS [American Association for Social Security] had prepared the ground for many years, were sound and socially desirable. Since their choice was "all-or-none" [italics mine] they voted for all and left it to the Supreme Court to separate the good from the bad. This was the tenor of debates in both houses.[2]

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[1]Paul Douglas, Social Security in the U.S., p. 109.

[2]American Association for Old-Age Security, "Social Security Bill Impractical," Bulletin, Vol. IX, No. 6 (June-July, 1935), p. 11.

In the next session, the major issues of debate, including the bill's complexity, are discussed in some detail.

Legislative History of the Economic Security Bill

The Congress moved quickly on the CES's Report. Only two days afters its presentation on January 15, 1935, the Economic Security Bill, capturing most of the elements of the Report, was introduced into Congress by Representatives David Lewis (D.-Md.) and R. L. Doughton (D.-N.C.), and Senator Wagner (D.-N.Y.). Hearings were held in the two committees simultaneously, commencing January 21, in the House Ways and Means Committee and January 22, in the Senate Committee on Finance. Hearings were completed in less than a month--by February 12, and February 20, respectively.[1]

Witnesses who appeared at the committee hearings were of five types: (1) those persons who supported and explained the bill such as the Secretary of Labor and Director Witte, both involved in writing the Report, and Senator Wagner, its Congressional sponsor; (2) constructive critics who supported the program in broad outline but felt improvements were necessary, among whom was Abraham Epstein; (3) proponents of alternative plans which would have delegated even more

[1]See Paul Douglas, Social Security in the U.S., for a detailed account of the legislative history of the Economic Security Bill from its introduction into Congress in January, 1935, to its passage in August, 1935.

power to the federal government; Dr. Townsend, Senator Long, and Representative Lundeen included; (4) proponents of alternative plans which would have reduced the potential for creating a large and powerful federal bureaucracy, for example, Senator Clark (R.-Mo.), who offered an amendment to allow private old-age insurance plans to "contract out" of the federal program; and (5) opponents of social insurance including Senators Hastings (R.-Dela.) and Gore (D.-Ok.), and the National Association of Manufacturers.[1] The Congressional committee hearings and outcomes were, as expected, dominated by the former two groups, but each group had some impact on the final product, if only to affect the political climate within which the new program operated.

Major Issues of Debate

From the evidence available, it appears that of the three programs designed to prevent and alleviate old-age proverty, the program to provide non-contributory pensions (welfare) to the elderly poor generated the least serious debate. On the other hand, a great deal of controversy was aroused by the contributory old-age annuity programs, both compulsory and voluntary. Indeed, as the bill made its way

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[1]For the actual debates, see U.S. Congressional Hearings before the Committee on Finance, U.S. Senate, 74th Cong., 1st Sess., on S. 1130 (January 22-February 20, 1935); Hearings before the Committee on Ways and Means, House of Representatives, 74th Cong., 1st Sess., on HR4120 (January 21-February 12, 1935); and "Is the Administration's Program for Old-Age Pensions Sound?" The Congressional Digest, Vol. XIV, No. 3 (1935), pp. 80-91.

through Congress, fairly significant changes were made in the compulsory program while the voluntary program was eliminated completely.

It was fairly generally believed that the elderly poor were not being provided for adequately at the state, local, and private level and, moreover, that they could not be provided for adequately at the decentralized level in the face of both interstate and international mobility. Unless other states were required to provide laws and meet certain minimum standards, the mobility of the poor would force the more progressive states into prohibitively (politically) costly programs or into enforcing very long state residency requirements. Further, lower income states in many cases could not afford to provide levels of benefits deemed adequate by other states. Of course, some states were unwilling to provide "adequate" benefits where a large proportion of recipients were racial or ethnic minorities. Finally, the Depression had left a number of states with pension laws without the funds to pay benefits.

Because states' rights were an important issue, a strictly federal relief program was not seriously considered, and the federal-state program was intended to be temporary, ultimately to be replaced by the insurance program. As this portion of the bill, which was nearly identical to the Dill-Connery bill, went through Congress, a series of changes were made which reduced the federal government's control over eligibility and benefit levels. By and large, however, the debates were of a technical nature and the final version of the bill was reported with little modification of the federal-state relationship or the nature of the subsidy.

Concerning the annuity program, more fundamental debates took place. Left-wing radicals were unsatisfied with the ability of the proposed program to redistribute income. Right-wing opponents were alarmed with the prospect of setting up a huge federal bureaucracy to compel the purchase of annuities through a single supplier--the central government. Why couldn't private insurance continue to provide for the retired or their survivors as usual? Or, why couldn't the federal government insure private plans? Why couldn't approved plans opt out of the federal insurance plan? Moreover, why mix issues, old-age poverty and insurance, by trying to enact legislation on several issues at one time?

The Bill's Complexity

Aside from the group of staunch social insurance advocates and those involved in drafting the CES report, people across party lines were concerned with the last question. According to Paul Douglas' account of the legislative history of the Act,

> Many Congressmen were opposed to the omnibus character of the measure and resented the Administration's attitude that it must be all-or-nothing [italics mine]. There were many who did not like to be forced to adopt a vast series of untried measures in the original drafting of which they had had no part.[1]

[1] Paul Douglas, Social Security in the U.S., p. 99.

There were two aspects of the Economic Security bill's comprehensiveness that were of concern. First, why were temporary relief measures combined with permanent programs? Second, why was such an assortment of programs combined (aid to dependent children, unemployment insurance, etc.; federal provision and state-federal provision; block grants, matching grants, and tax-offsets), when each required careful scrutiny? It is not, and was not, difficult to speculate on the reasons why. The recognition that the Administration was trying to force through an entire package of programs, radical ones tied to noncontroverial ones, in an all-or-none fashion worried Congressmen across party lines. Not only did the package of programs inhibit flexibility and scrutiny with respect to its parts, but also it put Congressmen in the position of voting for everyting or being labeled as opposed to "Social Security."[1]

Advocates of social insurance recognized the dilemma for opponents posed by the tied programs. The federal-state welfare movement had gained such popular support in Congress during the previous legislative session, that efforts to block the old-age insurance titles were made very costly. Moreover, Roosevelt had made it clear that the old-age insurance program was the heart of his Social Security program. There was simply no time to draft reasonable counter-proposals without

[1] See exchange between Senators Couzens, Hastings, and Wagner, in Hearings before the Committee on Finance on S. 1130, p. 21.

significantly delaying the provision of federal relief funds, already delayed some five years after the onset of the Depression.

Advocates, of course, recognized that permitting passage of the welfare titles without the insurance titles would have reduced significantly the probability of passing the latter. Not only would the power of the tie-in sale be eliminated, but also improved economic conditions would undoubtedly have proved to be a detriment to its passage. Reflecting the progressives' desire not to postpone the extension of the role of the federal government, President Roosevelt said, "It is childish to speak of recovery first and reconstruction later."[1]

As one might have expected, the bill as passed remained comprehensive. To the sponsors of the programs and social insurance advocates per se, comprehensiveness was the bill's greatest virtue.[2]

Individualism and Liberty vs. Centralization and Compulsion

Keeping in mind the rapid growth and proliferation of private insurance institutions, and the demands for old-age poverty relief, it is not surprising that there arose fundamental debates over the

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[1] Cited in American Association for Social Security, "Roosevelt Pledges Administration to Social Insurance," Social Security, Vol. VIII, No. 6 (June-July, 1934), p. 5.

[2] Abraham Epstein called the bill the "most outstanding and courageous program that has ever been attempted in the history of the world." See Hearings before the Committee on Ways and Means, House of Representatives, on HR4120, 74th Cong., 1st Sess., p. 552.

advantages and disadvantages of compulsory "insurance." Throughout the hearings, questions of individualism and liberty were contrasted by demands for centralization and compulsion.

Opponents of social insurance, including Senators Hastings (R.-Dela.), and Gore (D.-Ok.) of the Senate Finance Committee, quite aptly warned that a comprehensive federal program would threaten the individual property rights, destroy self-reliance and be contrary to American ideals. With regard to old-age insurance, opponents questioned how the private insurance analogy could be drawn legitimately by the terminology of "contractual rights" and "earned benefits." As Senator Hastings pointed out, the term contract connoted voluntary agreement between the parties involved as well as a legal right to the terms of the contract. A government program imposed on future workers was not voluntary and the nature of the political process could not guarantee benefits.[1] In the words of Senator Gore,

> Congress has found this bill on its doorsteps. What guarantee is there? Has the citizen got any constitutional guarantee? Has the citizen got any moral guarantee under this plan that some man might not come into power who would take more than he ought to take from one and give to another? . . . I know the theory of private property used to be--I do not say it is now--that the man who earned the dollar honestly

[1]See statement by Senator Gore in "Is the Administration's Program for Old-Age Pensions Sound?" The Congressional Digest, Vol. XIV, No. 3 (1935), pp. 83-85.

has a better right to it than anybody else. What I am trying to get at is whether this legislation is not out of line with this once established principle?[1]

Further, social insurance opponents recognized that the programs would require extensive new public institutions which by nature were bureaucratic, coercive and, in some cases, inefficient. Once established, such a pervasive program would be subject to increasing political demands and would suffer the same fate as previously tried public retirement systems for police, firemen, and government employees.[2] Benefits would be increased, coverage and eligibility would be liberalized, while the cost of the program and the size of the bureaucracy would skyrocket. This concern is aptly reflected in the following exchange in which Senator Hastings quite pointedly asked Senator Wagner, the bill's sponsor,

Sen. Hastings: Have you any assurance that this retirement program will be any more effective and the necessary funds to pay annuities will be accumulated any better than it is under the federal employees' system?

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[1] Ibid., p. 85. See also, statement by Hilding Siverson, Ibid., p. 91, in which he said "there are only two task masters to compel people to work for their livings. One is the natural necessity under an individualistic system, and the other is the drastic compulsion of a dictatorship."

[2] Some form of retirement pensions were already being provided for most of the employees in the federal government, the earliest and largest programs being veterans' pensions and military pensions. As of June, 1934, expenditures on these three systems amounted to nearly \$400 Million (\$1.6 billion). By 1935, fifteen years after its creation, the federal civil service employees retirement program had accrued a deficit of \$100 million (\$392 million), two and one-half times its annual expenditures in 1934. See The Congressional Digest, Vol. XIV, No. 3 (1935), p. 73.

Sen. Wagner: I think it will be properly administered.

Sen. Hastings: Do you happen to know that the government is already short $1 million in the amount that the federal employees have paid into that fund, to say nothing about their own contribution? . . . If the federal government has not succeeded in that small endeavor what assurance is there that it will succeed in this very much greater one?[1]

As special interest groups formed, each trying to pass their share of the cost on to other groups, there might eventually arise the need for the federal government to take over entirely the financing.[2] At that time, the program's function would have changed to one of income redistribution. The importance of the family, thrift, and economic incentives would be replaced by increased reliance on the federal government. It was this fact that prompted Noel Sargent of the National Association of Manufacturers to say, "This trend towards increasing the number of direct beneficiaries of federal funds is one to which every legislator and taxpayer must give most serious concern.[3]

Opponents went on to speculate that economic security, per se, could not be provided in a democratic society. Instead, such a goal would eventually require manipulation of the free production and exchange process upon which the American economy was based.

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[1]Hearings before the Committee on Finance, U.S. Senate, on S. 1130, 74th Cong., 1st Sess., p. 16.

[2]The Congressional Digest, Vol. XIV, No. 3 (1935), p. 70.

[3]Statement by Noel Sargent; see Ibid., p. 89.

> The suggestion that the federal government can guarantee security to its citizens is a false promise to bolster the New Deal demand for increasing federal power and, if adopted, will be but one step more toward a completely centralized federal dictatorship and paternalism.[1]

Income redistribution to alleviate poverty among the destitute (aged) was, opponents thought, a legitimate governmental undertaking; schemes to provide everyone with a "reasonable" standard of living were not.[2]

It is perhaps not too harsh a generalization to suggest that many social insurance advocates used the term insurance to their advantage, rather than to connote descriptive reality. Income redistribution was at the heart of their proposals and the coercive power of the federal government was the most effective way to achieve that end. By and large, they believed, as Townsend said, it was "folly to practice economy in a world of abundance." The economy had the resources to provide a reasonable standard of living to everyone, and since the resources were in the hands of a few individuals, the federal government's coercive power to tax was necessary to effect the redistribution.[3]

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[1] Ibid., p. 70.

[2] For a more recent statement of the view, see Friedrick von Hayek, <u>The Road to Serfdom</u> (Chicago: The University of Chicago Press, 1944); and <u>The Constitution of Liberty</u> (Chicago: The University of Chicago Press, 1960), pp. 285-305.

[3] See, in particular, Isaac Rubinow, <u>The Quest for Security</u>; Abraham Epstein, <u>Insecurity: A Challenge to America</u>; Eveline Burns, <u>Toward Social Security</u>, pp. 132-153; and statements by Rep. Benjamen Focht (R.-Pa.) and Rubinow in <u>The Congressional Digest</u>, Vol. XIV, No. 3 (1935), pp. 86, 88, 90.

Advocates were armed with studies conducted by the Brookings Institution that revealed the "maldistribution" of income in America. In 1929, Brookings' found there were 24,000 families with incomes over $100,000 enjoying a total income three-times that earned by the 6,000,000 families earning less than $1,000 a year.[1] Rubinow, in fact, cited that nearly half the population was living in "poverty," where a reasonable standard of living was defined as the "opportunity to enjoy life."[2] Thus for the staunch social insurance advocates, Rubinow and Epstein included, social insurance was admittedly a misnomer. Insurance, as they used it, did not have its foundations in the private sector. Their movement could have been more appropriately termed social "assurance." All individuals deserved, inherently, to be protected from the loss of income due to old-age, unemployment, disability, etc., while the federal government inherently had the command over resources required to effect the needed transfer. Universal protection could not be provided without compulsion. Adequacy could not be provided without centralization.

For those social insurance advocates who distinguished between welfare and insurance, the federal government was viewed as the preferred vehicle for insuring the masses against losses of income.[3] It

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[1] The Congressional Digest, Vol. XIV, No. 3 (1935), p. 80.

[2] Isaac Rubinow, The Quest for Security, pp. 8-11.

[3] See statement by J. Douglas Brown, in Congressional Digest, Vol. XIV, No. 3 (1935), pp. 82, 84.

was said that the government was able to insure poor people and old people--those who would find insurance prohibitively costly in the privator sector where insurance companies "worked for a profit." Collective foresight could replace the need for individual foresight, and risks could be pooled over a larger sector of the population to provide higher rates of return. In general, these arguments neglected to address the question of how the government could provide "adequate" benefits to the poor and elderly without subsidizing them at the expense of the young and higher income workers. Indeed, they neglected the "basic truism that insurance is not a means of lowering aggregate costs," but rather a means of redistributing these costs."[1]

More moderate advocates reasoned that welfare to the aged would become too costly and that a longer run insurance program that coerced participation was needed to prevent the problem of dependency before it occurred. While there may be, in fact, a reasonable argument for accepting the future and public problem of old-age poverty; it does not follow that this insurance must be purchased from a single supplier--the federal government.[2]

Nonetheless, advocates went on to add that adequate insurance could not be provided in the private sector because more progressive firms with pension plans would find themselves at a comparative cost

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[1]Robert J. Meyer, Expansionism in Social Insurance (London: Institute of Economic Affairs, 1970), p. 17.

[2]For more on this point, see Friedrick von Hayek, The Constitution of Liberty, pp. 285-305.

disadvantage--social insurance could equalize that disadvantage. Most persuasive in light of the ongoing Depression, the government could "guarantee" benefits and encourage the elderly to leave the labor force at a time when unemployment was particularly high.[1]

In response to cries of socialism from opponents, advocates answered with reminders that personal liberty or private property rights could be sacrificed in the light of the destitution wrought by the Depression. Other advocates responded with a matter-of-fact indifference. According to Representative Benajamen Focht (R.-Pa.):

> The outcry of state socialism which may be raised against the proposed legislation need deter no one. As a matter of fact, there is, I venture to say, no government of any civilized country, ours included, that has not to a greater or lesser extent embarked upon a policy of State Socialism.[2]

These fundamental issues were, of course, never resolved. Views of opponents and advocates stood juxtaposed to one another. In hindsight, the contrast in views helps explain the provision of relief in one program, and old-age insurance in another (although both part of the Economic Security Bill). A separate insurance program, with many elements of a private plan, provided an analogy that was a necessity for conservatives and a means of expediency for progressives.

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[1]See statements by Sen. Wagner (D.-N.Y.) and J. Douglas Brown in The Congressional Digest, Vol. XIV, No. 3 (1935), pp. 80, 82, 84. See also Ibid., p. 70.

[2]Ibid., p. 88.

The Payroll Tax and Tax Splitting

The Administration's choice of a payroll tax, nominally shared by employees and employers, was the subject of a great deal of Congressional debate. The tax, first employed to finance early German social insurance programs, was defended on the grounds that the employee and employer had an obligation to provide for the worker's financial future and that this type of wage tax most aptly conjured the private insurance analogy.[1] In the private sector, individuals covered by industrial insurance, for example, were accustomed to paying premiums on a weekly or monthly basis. Proponents recognized that the tax would be viewed similarly by covered workers as the payment of regular premiums in return for "earned contractual rights" to future annuities. On a more practical level, the tax would encourage women, children, and persons over sixty-five to leave the labor market at a time when unemployment was particularly high.[2]

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[1]Bismarck advocated the use of the split payroll tax for social insurance in Germany and utilized the insurance terminology as well. In his words, "our lack of experience in these matters [taxing employees and employers] has induced us to be very careful about the necessary <u>contributions</u> . . . the present bill is intended to keep the sense of human dignity alive . . . [the worker] should feel that he is no mere eleemosynary, but that he possesses a fund which is his very own." "Speech on Practical Christianity" (1914), cited in Marjorie Shearon, <u>Wilbur Cohen: The Pursuit of Power</u> (Washington, D.C.: Gray Printing Co., 1967), p. 4.

[2]See Paul Douglas, <u>Social Security in the U.S.</u>, pp. 62-68; and <u>The Congressional Digest</u>, Vol. XIV, No. 3 (1935), pp. 80, 82, 84.

Advocates of social insurance for income redistributive purposes were adamently opposed to a wage tax on workers as this was the subset of the population for whom the program was designed to benefit. For them, the progressive personal income tax was deemed a preferable means of finance. Organized labor argued the tax was too heavy a burden to place on already depressed wages and advocated its replacement by either a federal (progressive) government share or a relatively larger employers' share.

Concerning the employers' share of the tax, proponents suggested that employers were in part responsible for poverty among the elderly--by not setting up adequate pension plans, by not feeling a moral obligation for their support, by forcing early retirement, or even by not paying adequate wages--and, therefore, had part financial responsibility. Further, they asserted, this tax provided a simple automatic method of, ". . . meeting depreciation charges on human factors cooperating in production similar to the usual accounting charges for depreciation of plant and equipment."[1] Finally, progressive employers who had already set up pension plans would no longer be at a cost disadvantage.

Debates over the employer's share of the tax were seriously confused by the uncertainty of shifting and incidence. Specifically,

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[1]Statement by J. Douglas Brown, in The Congressional Digest, Vol. XIV, No. 3 (L935), p. 84.

did workers pay the tax via backward shifting, or employers via no shifting, or consumers via forward shifting? Either way, critics were armed. At the end of the Depression, both incomes and business activity were sluggish. Some said the tax would be shifted forward into higher prices thus enhancing the burden of the regressive payroll tax on workers. Or, as business interests suggested, the tax would be shifted backward, raising costs and lowering dividends. There was simply no agreement that in a competitive economy the tax imposed on employers would tend to be shifted to workers.[1] The imposition of a wage tax simply could not make labor more productive. By increasing costs, the employers share would be expected to reduce the demand for labor, lead to temporary layoffs and shifts of labor among industries until nominal wages had fallen by the value of the tax.[2]

Why was there a lack of exhibited understanding of the shifting and incidence of the wage tax? It was most certainly the case that the economics of the payroll tax was of secondary importance to the politics. "Expert" witnesses and other advocates of social insurance simply had no incentive to present balanced information. What then may have motivated

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[1]For an exception, see Russell Bauder, "The Probably Incidence of Social Security Taxes," American Economic Review, XXVI (September, 1936):463-465.

[2]This statement depends upon labor supply being relatively wage inelastic over the relevant range. Most empirical studies of labor supply substantiate this assumption. For a thorough discussion of the incidence of the payroll tax and a survey of empirical work, see John Brittain, The Payroll Tax for Social Security, Study of Government Finance (Washington, D.C.: The Brookings Institute, 1972).

the CES and other advocates to propose a payroll tax, and one with a nominal employer contribution? Concerning the first question, it seems evident that the private insurance analogy was, and has been, vital to broad-based political support for an old-age "insurance" program--it was politically expedient. Further, advocates recognized that the payroll tax would give worker-voters a vested interest in the long-run continuation of the program once established and collecting taxes. This motivation was most explicitly summarized by President Roosevelt when he said,

> I guess you are right on the economics, but those taxes were never a problem of economics. They are political all the way through . . . With those taxes there, no damn politician can ever scrap my program.[1]

The earmarked payroll tax would provide the new Social Security bureaucracy with "guaranteed" annual appropriations immune to competition from other governmental bureaus characteristic of general fund financing.

It remains an empirical issue whether or not earmarked taxes per se enhance bureaucratic control, but when an earmarked tax is utilized to finance an intergenerational transfer program and is compounded with the problem of an employers' tax payment that is generally not perceived as part of the workers' tax cost, the likelihood of enhanced bureaucratic control is increased dramatically.[2] Observation

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[1]Michael Schiltz, Public Attitudes Toward Social Security, p. 30.

[2]While the hypothesis that earmarked financing of old-age insurance increases bureaucratic control has not been tested directly, international studies of the determinants of Social Security expenditures indicate that earmarking leads to higher per capita expenditures

suggests that the split tax has served to hide the true tax cost of the program, and thus has relaxed competitive constraints on the bureaucracy. How is the worker to assess the incidence of a tax over which economists still disagree? Are benefits to be paid on the basis of true worker tax payments (employee plus employer) or on the basis of the nominal tax deducted from paychecks? How are "employer" tax payments to be distributed in benefits? By splitting the tax there has arisen the difficulty of not only assessing true individual tax costs, but also understanding the base upon which benefits would be based.

All of this confusion worked, and has worked, to the advantage of social insurance advocates. Advocates have been particularly active in advancing the no-shifting hypothesis as it biases upward benefit-cost calculations. Indeed, if workers believe there is no shifting when in fact they bear a greater tax burden, the relative advantages of a public "insurance" program vis-a-vis private programs are overstated. And, if social insurance advocates can misrepresent the benefit

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than general funding. See Joseph Pechman, Henry Aaron, and Michael Taussig, Social Security: Perspectives for Reform (Washington, D.C.: The Brookings Institute, 1968), pp. 294-304. Moreover, it is interesting to note that no funds were allocated from general revenues to the Social Security Board in 1936, its first fiscal year; and during its second fiscal year, still before the payroll tax was collected, the Board was financed with 20 percent less revenues than requested. See infra, pp. 286-287. For an alternative view of the impact of earmarking on individual and collective choice, see James M. Buchanan, "The Economics of Earmarked Taxes," The Journal of Political Economy LXXI (October, 1963):457-469; and Richard E. Wagner, "Revenue Structure, Fiscal Illusion, and Budgetary Choice," Public Choice XXV (Spring, 1976):45-62.

formula so that workers believe benefits are based on the total combined tax payments, voter-taxpayers will overstate the relative benefits of the public program.[1] Most important, and regardless of the degree of actual or perceived shifting, advocates have certainly been aware of the fact that rational choice on budget size and composition would be impossible when individual tax costs were uncertain.

Perhaps in response to self-interest, labor interests who would have rathered the rax be imposed on the employer (or offset by a federal share), business interests who have rathered the tax be imposed on labor (or offset by a federal share), and most sensitive to the private insurance analogy (most new industrial pension plans were financed by contributions from employers and employees), the CES suggested a tax imposed equally on workers and employers. The tax-splitting feature of the old-age insurance program was not modified as the bill went through Congress.

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[1]During the Senate hearings, Sen. Hastings remarked to Sen. Wagner, the bill's Senate sponsor, "it would be a little easier for this man to pay that [the payroll tax] if he knew that that contributed by his employer at the same time constituted part of the fund. . . . In other words, instead of returning to him 50 percent of that which has been accumulated for his benefit, why don't you return all of it to him?" Sen. Wagner responded, misleadingly, "it is all returned." Hearings before the Committee on Finance, U.S. Senate, on S. 1130, 74th Cong., 1st Sess., p. 29. Recall that the original bill provided a money-back "guarantee" on the employee's share only.

Federal Contributions and the Size of the Fund

In light of the current controversy over the advantages of a funded versus a pay-as-you-go system of Social Security, early arguments surrounding the appropriate size of the Social Security fund are of considerable interest. Originally, the CES recommended a quasi-funded, non-self-supporting, old-age insurance program. In particular, revenues would ultimately (not continually) be accumulated to cover all current and future liabilities; and part of these revenues would be derived from appropriations from federal general revenues (not only Social Security taxes). By the time the bill had made its way through Congress, however, the need for federal appropriations had been eliminated, scheduled tax rates had been increased and the old-age insurance program was modified to be fully-funded on a self-supporting basis.

Proponents undoubtedly recognized that some accumulation of reserves was crucial to the private insurance analogy and, therefore, to political acceptance. It was the degree of funding, however, that was the subject of controversy. A small fund with relatively low tax rates necessitated future federal contributions. This, of course, was favored by proponents of schemes to redistribute income as well as those who expected to gain from such redistributions.[1] On the other hand, opponents argued that if Social Security was intended to be an

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[1]See, for example, statement by Abraham Epstein, Hearings before the House Committee on Ways and Means, House of Representatives on the HR 4120, 74th Cong., 1st Sess., p. 558.

"insurance" program, there was no persuasive reason to transfer part of the cost of the program to future generations of workers or to non-recipients.[1]

Advocates of the CES proposal defended the government share in several ways: (1) "to buttress the guarantee of security," the taxing power of the federal government was necessary; (2)if unearned benefits were to be provided to the older workers, the federal government should logically cover this portion of the expenditures, (3) if the employers' share of the tax was shifted forward into higher prices, enhancing the regressivity of the payroll tax, contributions financed by more progressive taxes could be made to offset the regressivity; and (4) federal contributions could be used to keep both tax rates and the size of the fund low--both deemed "economically" desirable after the Depression.[2]

As advocates of income redistribution, social insurance proponents certainly recognized that a fully-funded self-supporting program would reduce significantly the ability to effect income transfers, both between and within generations. Not only would it constrain the ability to increase benefits indiscriminately by postponing tax rate increases (intergenerational transfers), but also it would constrain the

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[1]See, for example, statement by Noel Sargent in <u>The Congressional Digest</u>, Vol. XIV, No. 3 (1935), pp. 87, 89.

[2]See statement by J. Douglas Brown, Ibid., pp. 82,84.

ability to effect intragenerational transfers by eliminating supplementary revenues from federal progressive general revenues.[1]

Only the most outspoken social insurance advocates could have argued along these lines, however, since political acceptance relied on the private insurance analogy. It is undoubtedly for this reasons that the desirability of a large accumulated reserve was discussed in Congress predominately in terms of economics rather than politics. If economic rationalizations could be made to keep the fund low, that is unfunded, political rationalizations for relatively low tax rates and federal contributions would be superfluous. This is not to say that economic considerations were not important. Indeed, the Depression and a fear of intensifying the Depression were of great concern. In actuality, though, the economic arguments advanced against the accumulation of a large fund were misdirected and in many ways simply begged the issue.

The economic line of reasoning against the accumulation of a fund was as follows.[2] The imposition of the payroll tax with rates rising to create a self-supporting fund represented an immediate withdrawal of purchasing power which would not be offset by benefit payments until 1942. Since the tax bore most heavily on lower income

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[1]This point is examined more fully in Chapter IV.

[2]See Paul Douglas, Social Security in the U.S., pp. 56-58; and J. Douglas Brown in The Congressional Digest, Vol. XIV, No. 3 (1935), p. 86.

workers, whose marginal propensity to consume was relatively high, the withdrawal would result in a reduction in the demand for consumption goods and lead concomitantly to an increase in unemployment. If the sums so collected were then immediately invested, the increase in unemployment could be offset. One of the problems with the Depression, however, was viewed to be insufficient investment demand for newly produced capital equipment. If businessmen were hesitant to build new factories or buy new machinery, there was no guarantee that the reserves could be invested. If this were the case, then, there would result a reduction in and "sterilization" of purchasing power which would worsen the Depression. If, on the other hand, the funds could be invested, there might result an "undue diversion" of purchasing power from consumption goods to capital goods. As such, a large fund might be associated with not only difficulty in investing and liquidation, but also problems of investing and liquidation at "inpropitious" times.

Proponents of federal contributions and a small fund went on to suggest that another problem with investing a large funds was that the government might find it necessary to create new government debt obligations. If this were the case, other government expenditures could be bond financed rather than tax financed, creating a "paradox" whereby revenues from the regressive payroll tax on workers would help to relieve the tax burden on the rich.[1]

[1] J. Douglas Brown, Ibid., p. 86.

These arguments were misdirected in several ways. First, the possibility of investing the fund by purchasing private securities was not seriously entertained. Instead, as enacted in the original law, reserves were to be invested in special government bonds, or debt obligations for which bearish business expectations were of little importance. As purchasing power among covered workers was decreased, purchasing power amongst those individuals (whether private individuals, banks, or the federal government) who sold securities to the fund would be increased, with no net negative impact on the monetary and fiscal policy variables could not have been manipulated to offset a possible worsening of the Depression. Third, an "undue" diversion of purchasing power had little economic content for predicting the impact of the fund on employment and income; for indeed, the economy could be stimulated through either an increase in investment expenditures or an increase in consumption expenditures.

Despite the many political and economic arguments advanced against accumulating a fund, social insurance opponents and advocates of the private insurance analogy were successful in amending the bill on the grounds that the merits of a fully-funded, self-supporting program out-weighed other considerations. If the program was, indeed, an insurance program there seemed no persuasive argument for transferring, through federal contributions, part of the burden onto non-contributors (non-recipients), or onto future generations.[1] Since the payroll taxes were to be paid by workers in return for future benefits, they did not represent pure money losses.

With some understanding of the nature of debates that surrounded the Administration's bill and the difficulties of amending it, the modifications that actually were accomplished are of interest. Despite the fact that the 1934-35 Congress had the largest Democratic majority in history, the major impact of Congress was ameliorating. Among the major changes to eminate from Congress were: (1) the old-age insurance program was modified to be fully-funded; (2) the federal-state old-age welfare program was modified to reduce the federal government's discretion over recipient eligibility requirements; and (3) the voluntary annuities program was eliminated altogether. Moreover, amendments were seriously considered that would have reduced dramatically the role of the federal government. Among these were a proposal to eliminate old-age insurance altogether, and an amendment to permit the"contracting out" of certain established private insurance companies.

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[1]It is interesting to note the more recent literature on the theoretical gains to a pay-as-you-go system is, for the most part, irrelevant to the institutional design of Social Security in 1935. A true pay-as-you-go system in which current expenditures equalled current revenues was not advanced. Quasi-pay-as-you-go systems or non fully funded programs were advanced regularly, but as means of redistributing income or as means of elminating the sizeable political temptation to distribute the proceeds of the fund.

The Bill in the House

Important changes in the Economic Security Bill were proposed in Congress, the first of which were embodied in the bill as reported by the House Ways and Means Committee.

The Old-Age Insurance Program

Funding and Taxation. Generally assumed to be the greatest change in policy was the Committee's acceptance of Treasury Secretary Morgenthau's proposal to put the annuities program on a self-supporting basis.[1] Recall that in its introduced version, the bill called for tax rates rising from a combined rate of 1 percent, 1937-1941, to a maximum of 5 percent, 1957 and thereafter. The burden of unearned benefits was transferred to future generations. The impending actuarial imbalance was not scheduled to have been alleviated until federal contributions commended in 1965.

In order to keep the program on a strictly funded basis and to eliminate the need for federal contributions, Morgenthau suggested both reducing planned benefit levels and increasing planned tax rates, as shown in Table 18.

Morgenthau proposed a higher initial tax rate which rose more quickly, and for forty years, lower annuities, than the CES had recommended. The impact on the reserve fund would have been significant according to Committee estimates shown in Table 19.

[1]Paul Douglas, Social Security in the U.S., pp. 96-99.

TABLE 18

A COMPARISON OF COMBINED PAYROLL TAX RATES
PROPOSED BY THE CES AND MORGENTHAU

Year	CES	Morgenthau	Year	CES	Morgenthau
1937	1%	2%	1948	|	|
1938	|	|	1949	|	6% max.
1939	|	|	1950	|	
1940	|	3%	1951	|	
1941	|	|	1952	4%	
1942	2%	|	1953	|	
1943	|	4%	1954	|	
1944	|	|	1955	|	
1945	|	|	1956	|	
1946	|	5%	1957	5% max.	
1947	3%	|			

SOURCE: Paul Douglas, Social Security in the U.S. (New York: McGraw-Hill Book Company, Inc., 1939), pp. 58, 97.

TABLE 19

SIZE OF ACCUMULATED FUND UNDER ALTERNATIVE TAX RATE SCHEDULES (In Billions of Dollars)[a]

Year	CES	Morgenthau
1950	\$ 7.7	\$18.7
1965	\$15.3 (max)	\$42.1
1980	\$15.3	\$50.0 (max)

SOURCE: Paul Douglas, Social Security in the U.S. (New York: McGraw-Hill Book Company, Inc., 1939), p. 98.

[a]Current dollars.

Morgenthau's proposal to put the old-age insurance program on a self-supporting basis was supported by proponents of the private insurance analogy. In spite of the magnitude of the large estimated reserves and the fact that a self-sustaining program placed the burden of unearned benefits on younger workers, the Committee accepted the essence of the proposal. Tax rates were increased and the benefit formula was modified to put the system on a fully-funded, self-sustaining basis.[1]

Benefits. Rather than base benefits on average covered weekly wages and the number of weeks in covered employment, the Committee suggested that benefits be paid on the basis of total covered wages in covered employment with a different benefit formula, described in Table 20.

The new benefit schedule tended to benefit persons with low incomes and fewer contributing years, while the need for different benefit schedules for early and late entrants was eliminated.

Coverage. The House Ways and Means Committee reduced significantly the coverage of the old-age insurance program. Originally, all workers but government employees and persons covered by the Railroad

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[1]Ibid., pp. 102-103. As a point of reference, real assets of the Social Security system exceeded $50 billion in 1970 despite the fact that it had been converted to a pay-as-you-go system in 1939. See Table 38.

[2]Paul Douglas, Social Security in the U.S., pp. 102-103. This benefit schedule was accepted in the final bill and is illustrated and discussed more fully infra, pp. 195-196 along with a discussion of the original Social Security Act, pp. 204-205.

TABLE 20

BENEFIT SCHEDULE PROPOSED BY HOUSE
WAYS AND MEANS COMMITTEE
(Current Dollars)[a]

Benefits
Monthly benefit = 1/2% of the first $3,000 total covered wages,
1/12% of the next $42,000 total covered wages,
1/24% of all covered wages exceeding $45,000.
Minimum monthly benefit = $10.
Maximum monthly benefit = $85.

SOURCE: Paul Douglas, Social Security in the U.S. (New York: McGraw-Hill Book Company, Inc., 1939), pp. 102-103.

[a]In order to convert to 1975 dollars, multiply figures by four.

Retirement Act were covered by the Economic Security Bill. The following groups were excluded from coverage by the Committee: agricultural labor, domestic servants, casual labor, seamen, employees of non-profit organizations, and persons over 65. The reason put forth for excluding the first three groups was administrative infeasibility; it would simply cost too much to set up payment and coverage schemes for these persons. Employees of non-profit organizations were excluded in response to pressure by representatives of church and private charity funds. Supposedly, taxing churches and ministers for old-age annuities when the church had already set up retirement plans, would be double-taxing the church.[1]

The question remains. Why was this exception granted despite intense pressure by social insurance opponents and private insurance companies that could cite large numbers of other employees who were already covered under other plans?

Voluntary Annuities Program

In response to those social insurance critics who fiercely opposed public sector intervention in the insurance field, and in order to maintain the heart of the President's proposal--the old-age insurance program--the House Ways and Means Committee killed the proposal to provide voluntary annuities to the self-employed and uncovered workers, or workers wishing to supplement the compulsory program. The voluntary

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[1]Ibid., pp. 101-102.

program was eliminated on the grounds that it would have put the government in competition with private insurance companies.[1]

Old-Age Pensions

Opposition by Southern and Western Congressmen to the liberalization of eligibility requirements and to federally mandated standards across states resulted in a rewording of the original bill. Pensions were to be paid, according to the CES, to provide recipients with a "reasonable subsistence." The House committee reworded this so that there remained some interstate leeway, depending upon the particular "conditions in the state."[2] This change appeased Southern representatives and representatives of other states with large minority populations who feared the federal government would compel them, through uniform standards, to pay higher pensions to minority groups than state residents would have desired.

Further, the list of eligibility requirements, which if met necessarily rendered the individual eligible, were collapsed so that the citizenship requirement was the only explicit condition that could not bar an individual from benefits. This rewording allowed the state more flexibility in denying benefits for other reasons.

Other provisions were largely left in tact. Overall, the House Ways and Means Committee's reported version of those portions

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[1]Ibid., pp. 103.

[2]Ibid., p. 100.

of the bill pertaining to the elderly resulted in the following major changes:[1]

(1) Put the annuities program on a fully-funded basis.

(2) Reduced coverage.

(3) Liberalized the benefit formula in favor of lower income groups and persons with shorter periods of covered employment under the annuities program.

(4) Increased states' control over eligibility requirements under the pension program.

(5) Discontinued the voluntary annuities program.

Some important changes in administration were also made. Against the opposition of Labor Secretary Perkins, member of the CES, the Committee proposed that the Social Security Board be made an independent agency, not under the auspices of the Labor Department. Further, against the opposition of Harry Hopkins, member of CES, the Board rather than FERA was to be given control over the old-age pension program. Finally, in response to strong states' rights sentiments, and opponents of centralization, the federal authority to set minimum standards on state personnel were abolished.

The bill, as reported by the House Ways and Means Committee, was discussed for a week on the floor. Two hotly debated substitute bills, both significantly more radical than the Economic Security bill,

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[1] Report of the Committee on Ways and Means on the Social Security Bill, House of Representatives, 74th Cong., 1st Sess., Report No. 615 (April 15, 1935).

were introduced: a substitute for the old-age annuities and pension program (Townsend Plan), and a substitute for the unemployement compensation program (Lundeen Bill).[1]

Nonetheless, by April 19, the reported bill was passed without amendment by a vote of 371-33. Because of the all-or-none nature of the bill, the minority vote was comprised mainly of those persons most intensely opposed to the programs--conservative Republicans as well as advocates of the more radical substitute plans. Republicans on the House committee declared themselves in favor of increasing federal aid under the pension plan and declared themselves opposed to the compulsory old-age insurance system. Importantly, among the many amendments proposed on the floor, voted upon, and subsequently defeated, the amendment to reject the old-age insurance program entirely was among the few to muster a large number of proportion of votes (65-128)--30 percent of the votes cast were in favor of abolishing the old-age insurance program.[2]

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[1]The Lundeen bill was introduced by Farmer-Laborer Rep. Ernest Lundeen of Minnesota. The bill proposed the creation of a commission staffed by ordinary laborers and farmers that would administer unemployment compensation to anyone unemployed. More specifically, anyone out of work, for any reason, was to be paid a benefit equivalent to the average local wage for the entire duration of unemployement. See The Congressional Digest, Vol. XIV, No. 3 (1935), p. 79.

[2]Paul Douglas, Social Security in the U.S., pp. 109-110.

The Bill in the Senate

The House bill went to the Senate Finance Committee where it underwent important revisions.[1]

Compulsory Old-Age Insurance

Previously, there had been no clause in the bill reducing benefits for persons over sixty-five who continued to work. The Finance Committee, however, proposed that all benefits be forfeited should the individual work beyong the legal retirement age of sixty-five. The change, endorsed by President Roosevelt, was made on the grounds that: (1) it would encourage older workers to leave the labor market and make room for younger workers, and (2) it would eliminate, in the Committee's words, "the anomaly that employees over sixty-five may draw old-age benefits while earning adequate wages in full-time employment."[2] Of course, were the program truly designed as an annuity program, the work status of the elderly would have been immaterial. In light of the ongoing Depression, it seems evident that the amendment's impact on the employment decision of the elderly was most important.

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[1] See Report of the Senate Finance Committee, 74th Congress, 1st Sess., Senate Calendar, No. 661, Report No. 628.

[2] Paul Douglas, Social Security in the U.S., p. 111. Thomas Eliot, the principle draftsman of the Social Security Act, said that the previous omission of the work-clause was simply an "oversight." Thomas Eliott, seminar presented to Tulane University, March 17, 1977.

Voluntary Annuities Program

The Committee, in their draft of the bill, reinstated the voluntary annuities plan. It was to be placed, however, under the auspices of the Treasury rather than the Social Security Board.[1]

Old-Age Pensions

In response to conservative Southern pressure to reduce the discretionary power of the federal government in setting benefit levels, all reference to "reasonable subsistence" concerning the adequacy of benefit levels was removed.[2]

On June 18 and 19, the Senate committee bill went to the floor, where a more conservative influence was apparent. Numerous amendments to liberalize federal aid under the pension program were introduced, one of which was successful. Senator Russell (D.-Ga.) suggested that the federal subsidy of up to $15 per month per recipient be payable to states for up to two years even if they had not enacted old-age pension laws, and would not, therefore, be making pension expenditures themselves.[3] Several states were inhibited in their ability to enact legislation because of constitutional problems. As twelve of the fifteen states without laws were Southern states, Russell had the support of Southern congressmen. The amendment passed with little opposition.

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[1]Paul Douglas, Social Security in the U.S., pp. 111-112.

[2]Ibid., pp. 110-111.

[3]Cong. Rec. (January-August, 1935), pp. 9427; and Ibid., pp. 118-119.

The voluntary annuities program was, again, eliminated from the Senate bill in response to a movement led by Senator Lonergan. The Senator represented the state of Connecticut, headquarters of many private insurance companies, and successfully pleaded that this portion of the program would put the government in competition with a developing private sector.[1]

The Clark Amendment: The Threat of Competition

By far the most substantial change to eminate from the Senate floor was the Clark Amendment to allow certain private pension plans to "contract out" of the national compulsory insurance program. Senator Clark of Missouri had successfully introduced the amendment into committee, then resubmitted it to the entire Senate. It was a well designed, and with a 1970's perspective, a very interesting amendment that would have essentially put the government in the position of regulating private plans rather than monopolizing its own.

The basics of the Clark Amendment were as follows.[2] Private plans that would require combined premiums at least equivalent to the federal payroll tax rate and that could provide benefits (not necessarily rates of return) at least as great as those granted under the

[1]Paul Douglas, Social Security in the U.S., p. 116.

[2]See, in particular, Cong. Rec. (January-August, 1935), pp. 9942, 9510, 9513-9514,9630; and Paul Douglas, Social Security in the U.S., pp. 120-123, 252-265.

government plan were to be given the option to "contract out" of the compulsory program. The only other stipulations were that: (1) premiums had to be deposited with an ordinary insurance company or any other approved trustee; (2) if any employee's job was terminated, the company had to refund to the government the equivalent of his "combined premiums," and finally (3) the company's records and accounts were to be subject to federal scrutiny. Employees of firms that had contracted out would have their choice of plans: federal or private.

Clark argued quite convincingly that the compulsory program would create a large federal bureaucracy that would force many private companies out of business, even ones that could have potentially provided higher benefits; for indeed, few firms or workers would have been willing or able to continue financing private pension plans in addition to compulsory contributions to the federal plan. Private pension plans were currently covering more than 5 million persons, with an average monthly benefit level ranging from \$58-\$60 (\$234)--a figure in the upper range of scheduled benefits under the proposed Social Security bill.[1] The private alternative, which was yet relatively new but developing rapidly, would provide flexibility and freedom of choice not possible under a compulsory federal program. Most importantly, it was

[1]Paul Douglas, Social Security in the U.S., p. 252.

argued, private provision and competition must be considered the rule, and public provision the exception.[1]

It was difficult for critics to devise a convincing case against the Clark Amendment if Social Security was, as advocates aserted, an "insurance" program. Since private plans would have been regulated to comply by the provisions of the old-age insurance law, they would necessarily have been as "safe" and "actuarially sound" as the funded federal program. Since benefits paid by private plans would have had to have been as generous as those in the federal plan, they would have been, therefore, "adequate." If a compulsory program was deemed desirable to reduce the myopia problem and coerce short-sighted persons to save over their working lives, the private option would pose no problem. And, since workers would have had a free choice between the private and public plan, they could not have been "exploited" by private, profit-making insurance companies.

As such, the Clark Amendment posed a very serious threat to the viability of the federal old-age insurance program. By subjecting the federal plan to the efficiency generating forces of competition from the private sector, the government would have been forced, if only by default, to maintain a sound old-age insurance program. Voluntary patronage flows between competing suppliers would have reduced

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[1]Clark went on to say, "this program would result in the creation of a new, extensive federal bureaucracy" and would "undermine the fabric of our economic and social life by destroying initiative, discouraging thrift, and stifling individual responsibility." See Cong. Rec. (January-August, 1935), p. 9917.

dramatically the potential monopolization of the old-age insurance industry. At the least, the amendment (as would the private alternative) made the redistributive nature of the federal "insurance" program very clear. It was undoubtedly this fact that led the amendment to attract more heated, yet carefully worded, debates in the Senate and conference committee than any other.

Opponents of the Clark Amendment included sponsors of the Social Security bill, social insurance advocates, and income redistributionists, including Senators Wagner, LaFollette, and Harrison, and organized labor.[1] Critics argued, erroneously, that the introduction of Social Security would not eliminate or discourage the creation of private pension plans. Others argued that the private alternative would create an "inequity" whereby, depending upon the timing of a worker's privately and publicly covered employment, a worker who spent his early years in public coverage then chose the private alternative would receive an "inequitably" larger retirement income than would a

[1] See Cong. Rec. (January-August, 1935), pp. 1335-1338; and Pual Douglas, Social Security in the U.S., pp. 257-265. Moreover, "the Administration wanted desperately to stop it . . . and the White House assigned three experts to each of 12 Senators to change the vote." Thomas Eliot (principle draftsman of Social Security Act), "The Coming of the Social Security Act," seminar presented to Tulane University (March 17, 1977). It was perhaps this phenomena that led Sen. Clark to say, "no careful and intelligent observer in these unhappy times . . . can have failed to observe that this ceased to be a government in which legislation is by congressional consideration and vote, but has become a government by experts." See Cong. Rec. (January-August, 1935), p. 9627.

worker who timed his coverage in reverse.[1] Organized labor staunchly opposed the provision since a compulsory federal old-age insurance program would remove an important source of employers' leverage and improve labors' relative bargaining position in industry.[2]

The key argument advanced against the Clark Amendment was that contracting out would lead to an "adverse selection of risk" to the disadvantage of the public program. The downward weighted benefit formula would attract the near-elderly--those who were relatively costly to "insure." If this were to result, the government program would become prohibitively costly and would necessitate a reduction in scheduled benefits and/or an increase in scheduled tax rates.[3]

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[1] This is basically the same argument advanced in the 1970's for extending coverage to government employees. The redistributive benefit formula of the old-age insurance program pays a higher rate of return on the workers' first block of income so that there is, in effect, an optimal number of years to be covered (a number of years to maximize the rate of return). Then, should the worker opt for private coverage he can gain a potentially higher market rate of return on larger accumulated earnings. It is, of course, the benefit formula that creates the "inequity," not the private alternative. Opponents of the private alternative, however, argue that the government plan must be expanded to eliminate this anomoly.

[2] Since the choice of private or public coverage would have been at the discretion of individual workers within exempted firms, this argument by organized labor representatives implied that they supported coercing workers, who may have voluntarily chosen the private plan, into complying with the federal plan. In eesence, the introduction of a federal compulsory program and the elimination of the private alternative would reduce enforcement costs and provide a "public good" (an improvement in relative bargaining position) for union members.

[3] See Paul Douglas, Social Security in the U.S., pp. 257-263.

This argument made the redistributive nature of the program very clear, despite the "insurance" terminology. Indeed, a private plan could not have provided the relatively large benefits to early retirees, as required by the bill, without charging them significantly higher premiums. Without coercion, a private company in a competitive setting simply could not have provided unearned benefits or subsidies to one group of workers at the cost of another.

Arguments advanced by social insurance advocates and critics of the private alternative were not convincing. If, in fact, private pension plans were subject to federal audit to insure they provided the same "good," there were no persuasive reasons to permit a monopoly of the old-age insurance industry. As one opponent of the Clark Amendment, Paul Douglas, admitted,

> In view of all the safeguards, it seemed to the majority of the Senate and to a goodly section of the public that there was really no legitimate objection against granting such an exemption.[1]

Despite the fact that the Senate Finance Committee refused to entertain Senator Clark's proposal, the Senate passed the Clark Amendment by a vote of 51-35.

Shortly thereafter, the revised bill was voted upon and passed easily in the Senate by a vote of 76-6. Action by the Senate Finance Committee and the Senate floor had led to the following amendments to the House bill:

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[1]Ibid., p. 257.

(1) The determination of "adequate" pensions was left up to the states.

(2) States without pension laws could receive federal aid for up to two years.

(3) Persons working beyond the age of sixty-five had to continue to pay old-age insurance taxes, plus they would lose the full monthly benefit for each month of employment.

(4) Qualified private retirement plans could contract out of the compulsory old-age insurance program.

(5) The voluntary annuities program was eliminated.

The Bill in Conference

By mid-July, a joint conference committee had for the most part come to a compromise between the House and Senate versions of the Economic Security Bill. The Russell Amendment which would have allowed states a two year period of grace in setting up old-age pension schemes was modified so that local governments had to make contributions in order for the state to receive federal aid. Also, the Social Security Board was designated an independent agency.[1]

Most important, however, was the fact that no agreement could be reached on the Clark Amendment. The House strongly opposed it on the grounds that it would ruin the federal insurance plan; and the Senate refused to budge. The only point of agreement was that no

[1]See 74th Cong., 1st Sess., House of Representatives, Report No. 1540 (July 16, 1935).

agreement could be reached. They decided, therefore, to vote on the Economic Security bill without the Clark Amendment, then by "gentlemen's agreement" appoint a special joint legislative committee to study the matter more thoroughly and report to Congress January, 1936.[1] This was certainly a victory for advocates of social insurance.

The Social Security Act was then quickly passed by both houses of Congress on August 5, and signed by the President on August 14, 1935.

The Social Security Act: August, 1935

The original Social Security Act, as enacted August 14, 1935, constituted an unprecedented expansion in the role of the federal government. In only twenty-nine pages, the Act was divided into ten titles which created one federal compulsory program, the old-age insurance program (Titles II and VIII), a federal-state tax offset program for unemployment compensation (Titles III and IX), and three federal-state categorical grant programs (old-age assistance, Title I;

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[1] Cong. Rec. (January-August, 1935), p. 12793. Since the new Social Security program was not designed to begin paying benefits until 1937, Sen. Clark acquiesced to the agreement; see Ibid. It is interesting to note that the Clark Amendment was never reconsidered in Congress. This was perportedly because the private insurance industry thrived in 1935-1936, a phenomena that those most intensely interested in enacting the Clark Amendment believed was a result of the publicized need for insurance surrounding the enactment of Social Security. Thomas Eliot (principle draftsman of the Social Security Act), "The Coming of the Social Security Act," seminar presented to Tulane University (March 17, 1977). A more reasonable hypothesis is that the Depression itself "publicized" the need for insurance, as prior recessions had also led to a marked increase in private insurance activities.

aid to dependent children, Title IV; and aid to the blind, Title X). Two other programs were created with nonuniform federal grants to states for maternal and child welfare (Title V) and public health (Title VI).[1]

The Social Security Act provided for the elderly in two different ways. Under one program, the "Old-Age Benefit" program, monthly cash annuities were to be payable to persons at least sixty-five years of age who had contributed toward their cost. The "Old-Age Assistance" program, on the other hand, provided monthly pensions to the needy elderly whether or not they were covered by the annuities program. As embodied in the original Act, the two programs were designed to perform two quite different functions: the former constituted preventive social insurance; the latter constituted means-tested public welfare.[2]

The Old-Age Benefit Program (Title II)

Coverage. Every employee in the United States was covered (had to pay the payroll tax and was potentially eligible for old-age benefits) by the old-age benefit program, except:

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[1] The Social Security Act, Public No. 271, 74th Cong. [HR 7260]; Approved August 14, 1935.

[2] The terms "annuity," "insurance," and "pension" were not used in the original Social Security Act because of the desire to avoid constitutional problems. They are used here for simplicity since they were used by the President, in the CES Report, in Congressional hearings, and would be used again after the Supreme Court ruling in 1937.

(1) Agricultural labor.

(2) Domestic service in private homes.

(3) Casual labor.

(4) Seamen.

(5) Employees of the United States government, any of its instrumentalities, or state and local governments.

(6) Employees of any non-profit organization; including educational, religious, and scientific organizations.[1]

Benefits. Old-age annuities were to be payable to qualified individuals at the age of sixty-five, but no sooner than January 1, 1942. The equal monthly payments were payable until death, the amount of which was to be based on total covered wages paid between December 31, 1936 and the year before the individual attained the age of sixty-five. The benefit schedule is shown in Table 21. The minimum and maximum monthly benefits were set at \$10 (\$39) and \$85 (\$333), respectively.[2]

For comparison purposes, Table 22 illustrates the benefits payable under the annuities program. Note that these benefits were higher than proposed by the CES and more favorable to persons who would retire early in the life of the system with low earnings.

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[1]The Social Security Act, Sec. 210b. For a thorough discussion of the various titles of the Act, see Eveline Burns, Toward Social Security; and Paul Douglas, Social Security in the U.S., pp. 129-228.

[2]The Social Security Act, Sec. 202.

TABLE 21

BENEFIT FORMULA IN THE ORIGINAL
SOCIAL SECURITY ACT

Benefit
1/2% on the first \$3,000 of covered wages, plus
1/12% on the next \$42,000 of covered wages, plus
1/24% on wages exceeding \$45,000.

SOURCE: Social Security Act of August 14, 1935, Sec. 202.

TABLE 22

ILLUSTRATION OF BENEFITS PAYABLE UNDER THE OLD-AGE BENEFIT PROGRAM[a]
(Current Dollars)

Age in 1937	Yrs Contributed to the System	Date Benefits Payable	Average Monthly Earnings		
			$50	$100	$250 or more
60	5	1942	$15.00	$17.49	$24.96
50	15	1952	19.98	27.45	49.86
40	25	1962	24.96	37.41	62.46
30	35	1972	29.94	47.37	75.06
20	45	1982	34.92	53.64	85.00 (max)

SOURCE: Calculated on the basis of the benefit formula contained in the Social Security Act of August 14, 1935, Sec. 202.

[a]The Social Security Act was amended in 1939 before this benefit table was ever employed.

Earnings test. An individual who continued to work in regular employment beyond the retirement age of sixty-five, regardless of income, lost the full monthly benefit payment for each month of employment.[1]

Payments upon death. Any individual who had paid Social Security taxes was assured, by law, of receiving benefits equalling at least 3 1/2 percent of his total covered wages, whether or not he was entitled to this amount according to the benefit schedule. If an individual died before reaching the age of sixty-five, his estate was to be credited with 3 1/2 percent of his covered wages earned after December 31, 1936. The 3 1/2 percent lump sum payment constituted 1/2 percent interest on the maximum employee tax of 3 percent. Further, if the individual died during retirement, but before receiving the full 3 1/2 percent, his estate was to be credited with the balance.[2]

Qualified individual. Any individual whose total income during the period December 31, 1936 through the attainment of the age of sixty-five did not exceed $2,000 or who did not receive wages from covered employment on at least one day out of five different calendar years would not be qualified for monthly benefits.[3]

Payments to individuals not qualified for benefits. Any individual who, upon attaining the age of sixty-five, did not qualify for benefits was entitled to receive a lump sum payment a 3 1/2

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[1]Ibid., Sec. 202.

[2]Ibid., Sec. 203.

[3]Ibid., Sec. 210c.

percent of his total covered wages earned between December 31, 1936 and the year he turned sixty-five.[1]

Financing the Old-Age Benefit Program: A Matter of Interpretation

The mode of financing the original old-age insurance program is somewhat more difficult to explain since there was a divergence between the wording of the Act and what was, in fact, the intent of the Act. Because the constitutionality of the old-age benefit (or old-age insurance) program was seriously in doubt, the law was written as though the old-age benefit program would be financed by appropriations from general revenues. In a completely separate title, the payroll tax was described. No link was made between Title II benefits and Title CIII taxes since it was thought that a federal insurance program would, in fact, be unconstitutional.[2] It was taken for granted, however, that the Title VIII taxes would provide the source of revenue from which the Secretary of Treasury would make annual appropriations.

Annual Appropriations from General Revenues (Title II)

Each fiscal year beginning June 30, 1937, funds were to be appropriated by the Secretary of Treasury to the "Old-Age Reserve

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[1] Ibid., Sec. 204a. The lump sum refund (or money-back guarantee) was repealled in 1939. The lump sum death benefit was limited to six times the primary insurance amount in 1939.

[2] These issues of constitutionality are described in detail in Chapter IV.

Account," a newly created account in the Department of Treasury. Amounts appropriated were to be calculated "on a reserve basis in accordance with accepted actuarial principles." That is, the Treasurer had the responsibility to estimate the amounts required for benefit payments, given tables of mortality and a 3 percent rate of interest, compounded annually. Further, it was his duty to invest amounts credited to the account in excess of current withdrawals. These investments were specified to include only United States interest bearing obligations with at least a 3 percent annual yield. Accrued interest and the proceeds of sales were simply to be credited to the account.[1]

Payroll Taxes (Title VIII)

Payroll taxes (referred to as "income" taxes on employees and "excise" taxes on employers) were to be imposed equally on employees and employers at the combined rate shown in Table 23.[2] The tax on employees was to be deducted from each paycheck by the employer, up to the annual taxable ceiling of $3,000 ($11,765), and was not permitted as a deduction for the employee in calculating his net income. Payment of the combined taxes was to be made by the employer through the purchase of stamps, coupons, or any other forms of record keeping provided by the post office.

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[1]The Social Security Act, Sec. 201.

[2]Ibid., Secs. 801-811.

TABLE 23

SCHEDULED TAX RATES UNDER THE ORIGINAL SOCIAL SECURITY ACT

Years	Combined Rate
1937-1939	2%
1940-1942	3%
1943-1945	4%
1946-1948	5%
1949 and thereafter	6%

SOURCE: Social Security Act of August 14, 1935, Secs. 801-811.

Old-Age Assistance (Title I)

The original Social Security Act encouraged states, through matching grants, to provide for the needy aged within their boundaries. The Act stipulated the amount of grants to be made to the states as well as the attached provisions.[1]

In order to receive federal assistance, each state was required to formulate an assistance plan which was satisfactory to the Social Security Board (SSB). The following list describes the federal requirements on the state old-age assistance programs:

(1) The program had to be statewide and mandatory.

(2) The state had to participate financially.

(3) A single, state administrative agency had to be created with "efficient administration."

(4) One-half of any property collected by the state from the recipient's estate at death had to be turned over to the federal government.

(5) After January 1, 1940, no age requirements exceeding sixty-five could be imposed.

(6) No residency requirement which would exclude individuals who had lived in the state for five out of the previous nine years, with one continuous year preceeding assistance, could be imposed.

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[1]Ibid., Secs. 1-6.

(7) No citizenship requirement which would exclude a United State citizen could be imposed.

Should the state plan be accepted by the Social Security Board, one-half of all assistance payments to persons at least sixty-five were to be met by federal funds. The maximum pension which would be matched by the federal government was not to exceed $30 ($118) a month per person, while an additional 5 percent of this amount was to be provided for administrative costs. Funds were to be made available to the states on a quarterly basis, in amounts determined by the Social Security Board in conjunction with the state.

The Social Security Board (Title VII)

The Social Security Act also authorized the establishment of a Social Security Board, a three person committee to be appointed by the President with the advice and consent of the Senate.[1] The appointments were to be made for a period of six years, with one of the members designated, by the President, as chairman. The responsibilities of the Board were to include studying economic security, and making recommendations for legislation and administrative policy. Also, the Board was authorized to present a full report to the Congress at the beginning of each regular session. Finally, the Board was empowered to appoint and determine the pay for officer and employees deemed necessary to

[1] Ibid., Sec. 701-704.

execute the Social Security program. "Experts" could be appointed without regard to civil-service laws.

An Evaluation of the Original Social Security Act

While a 1970's perspective, one cannot help noticing the simplicity of the original Social Secuirty Act. Most notably, there was only one federal social insurance program, the Old-Age Benefit program, with only one type of beneficiary, the eligible retired worker; and its objectives were clear: (1) benefits (to contributing workers only) directly related to earnings, (2) limited coverage, and (3) fully-funded.[1]

While the benefit formula tended to favor the near-elderly, the redistributive impact was still relatively small, and the tax-benefit link was direct. Benefit tables had been designed to insure

[1]It is not at all inconsistent with the original Act to speak of a fully-funded program simply because the payroll tax revenues were not automatically appropriated for the support of the program. Title II had been written so that the Secretary of Treasury was required to make annual appropriations large enough to cover current expenditures plus all accruing liabilities.

It has been argued recently that the original program established a taxable ceiling that exceeded the incomes of approximately 90% of the covered population, and that the current ceiling should be increased to restore this relationship. This suggestion, which is advanced to increase the redistributive impact of the program, ignores the fact that limited coverage was also a key objective of the original program. In 1935, the redistributive impact, within the population, of raising the taxable ceiling was necessarily diminished since higher income workers (who could purchase adequate private insurance) escaped the program altogether.

that every worker received at least what he had paid in taxes (the employee's share only) plus interest, and importantly, that all workers with the same earnings histories were entitled to exactly the same monthly benefits. Finally, both benefit levels and tax rates were modest. At that time, there was no intention of providing a "reasonable standard of living" through the old-age insurance program. It was intended strictly as a means to supplement private sources of retirement income. Overall,

> Eligibility and benefits were closely work related, government contributions had been omitted, and fiscal conservatism prevailed in the emphasis upon reserves and the equity principles of private insurance.[1]

Statutory Constraints to Program Expansion and Redirection

In essence, then, the original Social Security Act institutionalized three important constraints on the ability to use the old-age insurance program as a means to redistribute income, both intragenerationally and intergenerationally. Benefits were earnings or tax payment related so that individual equity, both horizontal and vertical, was the driving force of the new program. Coverage was limited, and the program was designed to be fully funded.

If the program had maintained these objectives as benchmarks against which to consider amendments to the Act, these factors would have represented constraints to the program's scope and growth in the

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[1]Roy Lubove, The Struggle for Social Security, p. 175.

following way. Since benefits were to be paid only to those persons who had paid Social Security taxes, benefits could not have been legitimately extended to wives, dependents, survivors, etc., without supplementary tax payments from those persons who wished to receive additional benefits. The rule of benefits directly related to earnings for workers only would have eliminated altogether the ability to use the program for intragenerational-intra-income class transfers of income.[1]

Also, the program's coverage was limited originally to approximately 67 percent of the working population. Aside from excluding for administrative reasons certain lower income occupations, upper income occupations were excluded as well. Whereas the overall earnings of covered workers in 1937 was $900, the average earnings for all workers was more then 30 percent higher, or $1,258. In particular, government employees, self-employed doctors, lawyers, and other professionals--those persons most likely to be able to resort to private means of savings--were not covered in the original Act. Limited coverage along with a ceiling on taxable earnings clearly restricted the ability to use the program as a means of inter-income class-intragenerational transfers of income.

Perhaps the most important institutional constraint on the ability to exploit the program for redistributive purposes was the fact

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[1]Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 65; and U.S. Bureau of Census, Statistical Abstract of the U.S., p. 129.

that the program was intended to be fully-funded. This feature of the original program would have had the dual effect of drastically restricting potential growth since benefit promises to current workers and beneficiaries could not have been financed by tax claims on future worker-taxpayers. Instead, a fully-funded program would have essentially forced Congress to meet each additional dollar's worth of benefits promised with a current period increase in tax receipts sufficient to generate, with interest, balancing receipts. Moreover, the program was designed to be fully-funded without a federal government (progressive) contribution. Together, the funded program and a self-sustaining fund insured that both intergenerational and intragenerational transfers of income were minimized.[1]

Political Reality

These means of constraining the growth and redirection of the program, as characteristic of private insurance companies, were essential to the program's marketability, or broad-based political support. It seems unquestionable, however, that these same factors which were necessities from the point of view of opponents were at the same time political expedients from the point of view of advocates.

Conservative Congressmen were already fully aware of the inability of institutional constraints to limit the growth and scope of

[1]Each of these issued are discussed more fully in Chapter IV.

the Social Security program; for indeed, the Social Security law could (or did) do no more than bestow statutory rights upon individuals, protected by statutory guarantees. Unlike private insurance, public "insurance" could, as asserted by advocates, buttress its promises with the police and taxing powers of the state. But, unlike private contracts, the rights or claims chosen to be protected would be politically determined. Herein lay the seed to destruction of what had appeared to be a permanent and constrained program. The Social Security program created an apparatus through which coalitions of voters could vote for dollar transfers to themselves to be made good by claims on other workers' incomes. Referring to the inherent redistributive potential of the new program, that was disguised in the cloak of "insurance," Friedrick von Hayek said that it was

> . . . all a part of the endeavor to persuade public opinion, through concealment, to accept a new method of income distribution, which the managers of the new machine seem to have regarded from the beginning as a merely transitional half measure which must be developed into an apparatus expressly aimed at redistribution.[1]

Given that the political process could be used to rescind statutory rights, other salient features of the original Act are worth commenting upon as they set the stage for the growth and redirection the program has since experienced. Most importantly, benefits were directly but not proportionately related to earnings. The benefit formula had been weighted downward, purportedly, to provide benefits

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[1]Friedrick von Hayek, The Constitution of Liberty, p. 293.

to the near elderly who would not have had adequate time to earn a reasonable annuity. This created two problems. First, earned benefits and unearned benefits were all included in the same benefit schedule, within the same "insurance program" and therefore were in both cases to be paid as a matter of "right." Secondly, a weighting of the formula in favor of early retirees was at the same time a weighting of the formula in favor of lower income workers. This point was cleverly neglected by the bill's sponsors in their defenses of unearned benefits to the elderly. The old-age insurance program, thus, established unearned benefits to both early retirees and lower income workers to provide as a right what had not been paid for. Admittedly, it may have been difficult to create a federal program for the elderly and not bestow windfall gains to the near elderly as the Townsend plan was gaining, and continued to gain, momentum through 1939. On the other hand, there should be no presumption that it was also necessary to bestow these benefits in addition to old-age assistance to lower income groups.

In essence, then, the distinction between the objectives of the old-age insurance and old-age assistance programs was already confounded, and one could have predicted the emergence of increasing demands for larger unearned benefits as a matter of "right," or "social adequacy," or "social justice"--all to the neglect of tax payments. This development could have been constrained,

> . . . only if, from the outset, the distinction [had been] clearly made between benefits for which the recipient has fully paid, to which he has therefore a moral as well as a legal right, and those based on need and therefore dependent on proof.[1]

Afterall, what was there to constrain or even quantify "adequate," or "just," once the tax-benefit link had been broken?

The payroll tax was yet another feature of the original Act which would serve to enhance the monopoly power of the Social Security bureaurcracy. With regard to the tax-splitting feature of the tax, the question remains, who pays the total tax? The fact that economists, Congressmen, and Social Security officials are still debating the question suggests that the choice of a split tax with uncertain incidence would make accurate cost assessment by voter-taxpayers unlikely. While complete backward shifting of the employer's tax may be unlikely, no shifting is virtually impossible and simple observation would suggest that many covered workers understate their true tax cost. If this is the case, the net benefits of a public insurance plan vis-a-vis a private plan are surely artifically overstated. In any case, rational choice is impossible with this type of imperfect information.

In sum, despite the Act's apparent simplicity, within it lay the seeds of destruction. Most importantly, the Social Security law could do no more than bestow statutory rights to taxpayers, as opposed to contractual rights. As such, the institutional constraints embedded in the law which might have limited the growth and scope of the program

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[1]Ibid., p. 293.

and were necessary for broad-based citizen support were merely statutory and therefore subject to change. Also, the choice of the payroll tax made individual cost assessment virtually impossible; and finally, the introduction of insurance terminology was a "stroke of promotional genuis" that allowed advocates to "capitalize on the goodwill of private insurance."[1]

Response to the Act

The response to the Act was mixed. Conservatives remained ademently opposed to the federal old-age insurance program as it threatened individual liberty and property rights, not only currently but also in the future. It was clear in 1935 that the stage had been set for the creation of a large federal bureaucracy and for a redirection of the program to redistribute income and permeate other realms of private sector activity. Indeed, despite the Act's apparent simplicity, its enactment marked a radical departure from private sector, or decentralized public sector, reliance so characteristic of the period and brought about a permanent change in the relationship between the federal government and social welfare.

Liberals, on the other hand, praised the Act as a landmark in the history of social legislation. In the words of Abraham Epstein, the passage of the Social Security Act marked the enactment of

> . . . the most outstanding and courageous program that has ever been attempted in the history of the world . . . No man,

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[1]L. Meriam and K. Schlotterbeck, The Cost of Financing Social Security (Washington, D.C.: The Brookings Institute, 1950), p. 8.

> not even Bismark or Lloyd George, ever dared to present as comprehensive, as thorough-going, as vital a program in all its all-embracing aspects.[1]

In President Roosevelt's words, the Social Security program was "a cornerstone in a structure being built."[2]

From the outset, however, social insurance advocates disagreed over whether the old-age insurance program could "adequately" redistribute income and achieve the desirable "social objectives." Coverage was not universal, benefits were tied to earnings, and there appeared to be a preoccupation with individual equity. Also, benefits were restricted to the elderly--there was no health insurance, disability insurance, medical insurance, or "cradle-to-grave" protection.[3]

Social insurance advocates undoubtedly recognized, however, that an expansion or redirection of the program was only a matter of time. The Social Security Board, entrusted to initiate policy, was likely to be staffed with expansionists; and special interests groups were already aligning to exploit the redistributive potential of the program by demanding larger benefits and a transference of costs.

By 1939, the most radical redirection in the history of the program was effected. Social insurance expansionists within the newly created Social Security Board had seen eliminated the two real

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[1]Hearings before the Committee on Ways and Means on HR 4120, House of Representatives, 74th Cong., 1st Sess. (January 21-February 12, 1935), p. 552.

[2]Arthur M. Schlesinger, The New Deal in Action, p. 31.

[3]Roy Lubove, The Struggle for Social Security, pp. 175-178.

constraints on the ability to use the program to redistribute income and to affect political support: individual equity and a fully-funded program. The concept of individual equity had been abandoned for "social adequacy;" the funded program was dismissed for a pay-as-you-go system; and the program's complexity was increased many-fold.

Chapter IV

THE INSTITUTIONALIZATION OF EXPANSIONARY FORCES, PROGRAM REDIRECTION, AND THE ELIMINATION OF INSTITUTIONAL CONSTRAINTS ON INCOME REDISTRIBUTION: 1935-1960

> Passing the laws is only, as it were, a "curtain-raiser" in the evolution of such a program.[1]

Introduction and Summary

Purpose and Scope

Only months after the Social Security Act was passed in August, 1935, President Roosevelt had appointed the three member Social Security Board and its staff was being organized. Since the staff nucleus of the newly created agency was drawn largely from the ranks of social insurance advocates affiliated with the Committee on Economic Security, the Committee that formulated the Social Security program, expansionary forces had already been internalized into the Social Security bureaucracy.

Four years later, the most radical redirection in the history of the Social Security program had been accomplished, rendering the private insurance analogy no longer applicable. Both the goals of

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[1]Arthur J. Altmeyer, "Progress and Prospects under the Social Security Act" (address before the National Conference of Social Workers, May 25, 1937, unpublished, U.S. Department of Health, Education and Welfare). The arguments made in this introductory section are documented in the chapter.

individual equity and a fully-funded program had been dismissed for the attainment of "social adequacy" goals and a pay-as-you-go system. Enacted before any monthly benefits had been paid under the old-age insurance program, the 1939 Amendments marked the first redirection and expansion of the program that had been "recommended" by Social Security officials, endorsed by the Advisory Council on Social Security, and demanded by special interest groups.

In the following twenty years, the metamorphosis of Social Security from a limited objective old-age insurance program to a broad-scale and complex redistributive scheme had been virtually completed. By 1960, there were multiple beneficiary categories with diverse eligibility requirements; there were two new social insurance programs for dependents and survivors, and the disabled; coverage was all but universal; the program was no longer fully funded; the distinction between the objectives of the old-age insurance and the old-age assistance programs was hardly meaningful; and the complexity of the program had increased to the point that bills to amend the Act, of which hundreds were introduced into each session of Congress, numbered hundreds of pages.

Given the apparently limited nature of the old-age insurance program in 1935, as well as its lack of broad-based political support, how can this evolution to a highly complex, redistributive program be explained? This question is the major concern of Chapter IV. Several other questions are also addressed since they provide economic and political insight into this broader phenomenon. For example, recognizing the importance of supply-side control over the original institutional features of the program, can this later course of events be explained by simple supply-side models? If the bureaucracy did dominate the evolution of the program, what were its sources of power and how was it able to overcome the initially intense opposition to compulsory old-age insurance? How was the bureau able to shield itself from competitive pressures from the local public sector and private sector? What were the revealed political strategies for expansion of the program? What was the impact of both eliminating the fund in 1939 and expanding coverage during the 1950's on the monopoly position of the bureau and the ability to employ the program to redistribute income? Indeed, can the evolution of the program from 1935-1960 be explained as the outcome of an active bureaucracy influencing the forces that generate income redistribution?

Summary of Developments

The evidence presented in this chapter suggests that the rapid growth and institutional proliferation that characterized Social Security's first twenty-five years were the direct result of: (1) the monopolization of the old-age insurance industry which permitted a selective bias in information made available by the bureaucracy to resident-voters; and (2) the creation of a program with income redistributive potential to which millions of Americans became direct beneficiaries of public funds. Each of these developments were firmly established in the first five years of the program's life.

To an important extent, the monopolization of the old-age insurance industry took place with the enactment of the Social Security Act. The introduction of the compulsory old-age insurance program compelled purchase from a single supplier--the federal government--and in so doing, necessarily reduced the information and efficiency generating forces of competition from the private sector. Moreover, the creation of the compulsory old-age insurance program eliminated voluntary patronage flows as an indicator of social value; it destroyed, at least initially, the comparative advantage of private insurance companies by reducing their pool of customers and, perhaps, increasing their relative administrative costs; and it destroyed in the long-run the competitive advantage of private companies in providing insurance to the poor and near-elderly by introducing redistributive features into the benefit formula.

The monopolization of the industry thus increased significantly advocates' control over the production of information. Indeed, advocates within the new Social Security Board, who had been carried over from the CES, were now federally funded to both disseminate information and draft legislation. With this source of power, and whether for ideological or self-interested reasons, Social Security bureaucrats could not have been expected to produce balanced information on the costs and benefits of their program relative to that available in the private sector, or to advance proposals to limit the growth of the program. Instead, they had every incentive to use their influence to expand the scope and complexity of Social Security. In the words of Ellen Woodward, member of the Social Security Board, "Our steps toward Social Security have been sound steps but they have not yet led into all our homes nor all of the situations that breed hazard and insecurity."[1]

Given this potential control over the production of information, were there no constraints on the bureaucracy in leading to an expansion and redirection of Social Security? To the contrary, since compulsory old-age insurance had emerged from Congress without broad-based political support, the new bureau was particularly vulnerable; for indeed, the operation, administration and political support associated with each of the new programs were no longer inextricably tied to one another. The new bureau of Old-Age Benefits was in an independent position from which it had to derive its own sources of power and influence. Since the payroll tax would not be collected for two years, the Bureau was in the position of having to compete with other government agencies for funding. Moreover, since the creation of a compulsory old-age insurance program had generated large uncompensated losses for those private firms which had been producing substitute goods while benefits were not payable for seven years, there were yet few direct beneficiaries of the program whose support could be employed by the bureaucracy to offset the early opposition.

The early years in the life of the bureau were, therefore, crucial to its resulting longevity for it was during these years that the

[1]E. S. Woodward, "Social Security Today and Tomorrow" (address before the Mississippi Conference of Social Workers, Jackson, Miss., April 29, 1943, unpublished, U.S. Department of Health, Education, and Welfare).

threat of competition was keenest. Almost immediately, the Social Security Board and the Bureau of Old-Age Benefits were faced with problems of funding, attacks during the 1936 Presidential campaign, and continued pressure from a movement demanding large gratuitous transfers to all elderly persons--each of which made their role as an information-generator all the more important. During these same years, however, the bureaucracy was "effectively paralyzed" in its ability to market its output because of serious doubts concerning the constitutionality of the Social Security Act. Regarding the old-age insurance program, it was generally believed that the federal government was without constitutional authority to administer a compulsory "insurance" program.

Due to a series of circumstances fortuitous to the bureaucracy, however, mid-1937 marked a brighter future for Social Security. Following a bitter "court-packing" controversy initiated by President Roosevelt, the old-age insurance program was found constitutional not as an insurance program but as an unrestricted tax-gratuitous transfer program and was validated along with a series of pending laws that had previously been of questionable constitutionality. Moreover, against a backdrop of many other politically popular programs enacted by Roosevelt during the depression, conservative Presidential opposition to the old-age insurance program was not made effective. By 1937, then, the federal government had begun collecting the payroll tax, all the titles of the Act had been validated, President Roosevelt had been reelected, and Democratic majorities in Congress had swollen. In short, the Social Security

Board was in a better position from which to amass political support for expansion.

Almost immediately thereafter, the need to alter the nature of the program became apparent to Social Security bureaucrats and President Roosevelt--in essence, the need to begin paying benefits earlier than scheduled. Such a change would have had the effect of speeding up the creation of vested interests in the maintenance of the program, creating voter-coalitions of beneficiaries whose interests would become increasingly coincidental with those of the bureaucracy, and necessitating the elimination of the build-up of a fund. Each of these developments would serve to buttress the monopoly power of the bureau.

With an accumulated fund of $1.7 billion ($6.6 billion) in 1939, the interests of fiscal conservatives and taxpayer groups could hardly offset the "demands" of social insurance expansionists who included President Roosevelt, the Social Security Board, a carefully chosen "Citizens' Advisory Council on Social Security," Abraham Epstein and the American Association for Social Security, and representatives of the elderly and organized labor. In 1939, before any benefits had been paid, the old-age insurance program was overhauled. The fund was eliminated for a pay-as-you-go system, and individual equity was abandoned for the goal of "social adequacy"--changes which were facilitated by passing them along with windfall gains to most workers who would retire in the early years of the program. Indeed, the apparatus had been created in 1935 over which the bureaucracy maintained the power to propose, draft, and disseminate information on program changes; and through which special interest groups could align to exploit the redistributive potential of the new program.

Three of the changes enacted in 1939 would prove to be crucial to the program's future course. First, a downward weighting of the benefit formula and the introduction of survivors' and dependents' benefits not only reduced competition by differentiating the product from that attainable privately, but also removed the individual equity benchmark as a quantitative standard for future changes. Indeed, once the distribution of benefits had been divorced from the work of the actuary, and placed in the hands of unrestricted majority voting, the resulting distribution of benefits need bear little relation to that which might have been considered equitable. Second, scheduled benefits were actually reduced from their 1935 levels for certain beneficiaries. By bestowing uncompensated losses on these taxpayers, this change clearly elevated the redistributive potential of the new program since it indicated there were, in fact, no implied minimum or "guaranteed" rates of return payable. Finally, when the funded reserve principle was abandoned, so was an effective political constraint on the size of the old-age insurance program and the ability to transfer the cost of the program onto future generations. Under a pay-as-you-go system not only would rates of return be politically determined and therefore a function of the extent to which taxes could be imposed on other, perhaps non-voting, future generations, but also because of the clear lack of competing suppliers of such a good, the information role played by the bureaucracy particularly with regard to such issues as the actuarial status of the program and rates of return payable would be significantly greater than with a funded program.

In essence, each of these changes, the implications of which are examined in detail in the Chapter, complicated the program manyfold thus reducing the ability of voter-taxpayers to assess true individual tax costs; redirected it from its initial insurance objectives; and by buttressing the monopoly power of the bureau, set the stage for the growth the program has since experienced. Importantly, all of this took place at the same time insurance terminology (insurance, fund, trustees, contributions) was introduced formally into the Social Security law. While this had not been done earlier because of its likely ramifications on the constitutionality of the Act, it too would be crucial to the program's growth and emergent popularity.

Once two of the three major objectives of the original program had been eliminated in 1939--funding and benefit payments to worker-taxpayers only--the bureaucracy persistently advocated universal coverage as the next step in "perfecting" the program. Given a choice among fiscal variables which included tax rate increases, taxable earnings increases, and coverage expansion, their strategy was certainly rational as it was, at that time, the finance scheme of least resistance. Indeed, coverage expansion was not only politically appealing to currently covered workers, current beneficiaries, and social insurance advocates, but also was demanded by many uncovered groups of workers.

In essence, coverage expansion was a direct means through which each group could exploit the redistributive potential of the new pay-as-you-go system. Coverage expansion dispersed tax costs for currently covered workers; produced windfall gains to current beneficiaries; permitted uncovered workers, particularly the lower income and near-elderly, the opportunity to take advantage of the very high rates of return payable in the first decades of the program's operation; and from the point of view of Social Security bureaucrats, represented an important and, at that time, noncontroversial way of reducing competition. The existence of large groups of uncovered workers, particularly higher income workers, who relied on private voluntary savings institutions was not only permitting the growth of alternative and competing sources of supply, but also limiting the range of possible redistributive outcomes. As coverage was expanded from six out of ten workers in 1950 to nine out of ten in 1960, headway was made toward tackling this problem while helping to finance an 875 percent increase in real expenditures over the decade.

The nature of the rapid increases in expenditures made possible by the expansion of tax sources during the 1950's can be explained in either of two ways. On the one hand, the introduction of new beneficiary groups, the liberalization of benefit eligibility requirements and the increasing tendency to downward-weight the benefit formula can be explained simply as institutional responses to demand-side pressures. Indeed, recognizing the tremendous incentive of beneficiary groups to lobby for changes that would generate large windfall gains to themselves, and recognizing that there were 7.9 million such direct beneficiaries during the 1950's, this is certainly a plausible hypothesis. On the other hand, is it not possible that these demand-side pressures for institutional change were the result of previously legislated institutional changes? The institutional evolution of Social Security has witnessed many times the impact on voter-demands of bestowing special benefit increases to "particularly deserving" subsets of voters. Very quickly, demands emerged for "uniformity" or an expansion of the program to eliminate a seeming "inequity." With majority voting and imperfect information, an active bureaucracy certainly has the incentive to encourage this type of program proliferation.

Regardless of which explanation is accepted, however, they resolve to the same observation. The growth and proliferation of Social Security between 1935-1960 evidenced most clearly the difficulty of constraining redistribution and expansion when the demands of special interest beneficiary groups were increasingly coincidental with the interests of the bureaucracy. Indeed, rather than take advantage of the inverse relationship between the number of covered workers and the tax rate needed to finance any given level of expenditures under a pay-as-you-go system, coverage expansion was employed fairly extensively during the 1950's as a means to finance new and larger benefit claims that would have to be financed in the future by a less rapidly growing stock of covered workers.

In many ways, the institutional changes enacted after 1939 can be viewed as the outcome of a redistributive game in the absence of rules to define permissible fiscal outcomes and in the presence of an active bureaucracy. The role played by the bureaucracy in these developments, particularly in reducing taxpayer opposition to costly program expansion, is seen as all the more important when one takes account of the fact that during this entire period Social Security officials publicly advanced the notion that the program was financed on funded reserve principles.

The Roosevelt Years: 1935-1940

In the decades following the program's enactment, both Social Security and the bureaus created to administer it were destined to become large political institutions with widespread political support. Given the lack of broad-based support for the old-age insurance program in 1935, two questions naturally arise. First, at what point did the program gain popular support? Second, what were the key factors that accounted for its emergent popularity? Some might argue that early opponents did not fully recognize the individual and social benefits to be derived from a federal old-age insurance program. As such, its actual operation--tax collection and benefit distribution--generated the necessary information. Alternatively, it has been argued that it is the existence, per se, of a government program that conditions expectations and generates demands for its continuation.[1]

[1]Alexis de Tocqueville, as cited in E. G. West, "The Political Economy of Public School Education," The Journal of Law and Economics, X (October, 1967), p. 128.

Neither of these responses provide any true explanatory power. Indeed, the former argument relies on the contrary assumption that the monopolization of an industry generates superior information; while the latter argument lacks an underlying economic and political basis. The question remains. How can we explain the metamorphosis of Social Security from a limited objective program with limited political support to the largest domestic program in the United States with widespread political support? A resolution of these types of issues is crucial to an understanding of the operation and evolution of governmental institutions.

In most general terms, Social Security's emergent popularity and rapid growth were a direct result of: (1) the monopolization and bureaucratization of the old-age insurance industry which permitted a selective bias in the information made available to resident-voters; and (2) the creation of a program with income redistributive potential which created a situation in which millions of Americans were direct beneficiaries of public funds. Both of these factors, which got their foothold during the Roosevelt Administration, are examined in turn.

Staffing the Social Security Board: The Institutionalization of Expansionary Forces

The Social Security Board came into operation as a permanent, independent agency in the fall of 1935. Only months after the Act was signed in August, President Roosevelt had appointed to the Board John Winant (Chairman), Arthur Altmeyer, and Vincent Miles; and their staff was being organized.[1] The staff nucleus of the newly created agency was drawn largely from the overlapping group of staff members of the Committee of Economic Security (CES) and social insurance advocates who had played the major role in formulating the Social Security program. Whereas the membership of the President's CES had been dominated by high ranking bureaucrats from existing agencies, and the membership of advisory councils to the CES had been dominated by representatives of labor and social reformers, the Social Security Board was staffed primarily by influential persons affiliated with the CES.[2]

> The Social Security Board was in a double sense a continuation of the CES: not only were its activities an application of the new functions envisaged by that investigating committee, but the staff nucleus with which the board began was carried over from the committee.[3]

Table 24 reveals the extent of staff carry-over from the CES to the Social Security Board.

It should not be surprising that the original staff of the Social Security Board was comprised of social scientists and bureaucrats who had been social insurance advocates as they were the ones with exhibited interest in, and knowledge of, the program and its

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[1]For a detailed account of the financial and organizational aspects of the Social Security Board in its early years, see Charles McKinley and Robert W. Frase, Launching Social Security: A Capture-and-Record Account, 1935-1937 (Madison: University of Wisconsin Press, 1970).

[2]In a strict sense, the President's Committee on Economic Security (CES) was comprised of cabinet level officials. For simplicity, however, CES will also be used to designate the various advisory councils to the Committee since they were instrumental in formulating the original Social Security Act.

[3]McKinley and Frase, Launching Social Security, p. 18.

TABLE 24

STAFF MEMBERS OF THE SOCIAL SECURITY BOARD
AND THEIR PRIOR POSITIONS

Name and position	Prior positions
John G. Winant, Chairman, Social Security Board	Governor, New Hampshire; Director, International Labor Org.; Member, CES Advisory Board
Arthur J. Altmeyer, Member, Social Security Board; Chairman after the resignation of Winant, 1936.	Second Assistant Secretary of Labor; Secretary, Wisconsin Industrial Comm.; Chairman, CES Technical Board
Vincent Miles, Member, Social Security Board	Lawyer, Member of the Democratic National Committee
Frank Bane, Executive Director, Social Security Board	Director, American Public Welfare Association; Chief, Tennessee Welfare Department
Thomas Eliot, General Counsel, Social Security Board	Associate Solicitor, Department of Labor; Member, CES Technical Board; Chief draftsman of the Social Security Act
Henry Seidemann, Director, Bureau of Old-Age Benefits	Member, Brookings Institute
Jane Hoey, Director, Bureau of Public Assistance	Professional social worker; Associate Director, New York Welfare Council
William Williamson, Chief Actuary, Bureau of Old-Age Benefits	Travelers Insurance Company; CES, Actuary on Unemployment Compensation Staff
Robert Meyers, Assistant to Chief Actuary, Bureau of Old-Age Benefits	CES, Actuarial Assistant

TABLE 24--Continued

Name and Position	Prior positions
Walton Hamilton, Director Bureau of R & S	Director of the Graduate School of the Brookings Institute Chairman, NRA Advisory Council
Ewan Clague, Assistant Director, Bureau of R & S	Faculty member, University of Wisconsin; CES, Consultant to Employment Opportunities Staff
Wilbur Cohen, Staff member, Bureau of Unemployment Compensation	CES, Research Assistant to Executive Director Witte; Aid in drafting the Social Security Act

SOURCES: Marjorie Shearon, Wilbur Cohen--The Pursuit of Power: A Bureaucratic Biography (Washington, D.C.: Gray Printing Co., 1967), pp. 39-41.

McKinley and Frase, Launching Social Security, pp. 495-503.

administration. This initial staffing-screening process, however, coupled with Civil Service laws that would shield bureaucrats from political competition, institutionalized expansionary forces.[1] To draw a staff nucleus from twenty influential members of the CES, the executive committee appointed to create a social security program and which had drawn its staff largely from social insurance advocates, insured internal pressure for growth. The establishment of the initial social security bureaucracy, although still small, combined expansionists of two types: those who based on personal values sought an extensive social insurance system or public sector per se, and those who found their future incomes tied to the program's growth.

The creation and staffing of new bureaus is of vital importance to their longevity as it is the extent of the resulting monopolization and bureaucratization that permits supply-side control in the collective choice process. With respect to Social Security, the introduction of a compulsory old-age insurance program that forced purchase from a single supplier--the federal government--necessarily reduced the information and efficiency generating forces of competition from the private sector. The creation of the old-age insurance program eliminated voluntary

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[1]As noted by the past Chief Actuary of the Social Security Administration, civil service appointment of upper level staff members produces a situation in which the bureaucracy can take on momentum of its own in policy planning, independent of the desires of the administration. In his words, "How can he (a high-ranking civil-service technical employee) be expected to produce a vigorous, airtight rebuttal for his political superior to an attack on administration proposals ." if it is inconsistent with his own desires as a "public advocate." See Robert J. Myers, <u>Expansionism in Social Insurance</u> (Westminster: The Institute of Economic Affairs, 1970), pp. 29-30.

patronage flows among private and public insurance carriers as an indicator of social value; it destroyed, at least initially, the competitive advantage of private insurance companies by reducing their pool of customers and, perhaps, increasing their relative administrative costs; and it destroyed, in the long run, the competitive advantage of private companies in providing insurance to the poor and near-elderly by introducing redistributive features into the benefit formula.[1]

Moreover, the bureaucratization of old-age insurance enhanced manyfold the advocates control over information. Advocates within the bureaucracy were now federally funded to undertake research, disseminate information, initiate and draft legislation. They were in the position of determining not only what was studied and proposed, but also what was not.[2]

In essence, the absence of private producers of viable substitutes would make possible a selective bias of information. Whether for ideological or self-interested reasons, Social Security bureaucrats could not have been expected to provide (nor have they provided) balanced information on the relative costs and benefits of their program

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[1]Holding administrative costs constant, a reduction in the size of the firm may necessitate larger reserves and, therefore, higher premiums, to offset the risks of accidental or random fluctuations in benefit claims. See Robert J. Myers, Social Insurance and Allied Government Programs, Irwin Series in Risk and Insurance (Homewood, Illinois: Richard D. Irwin, Inc., 1965), p. 7.

[2]For a more thorough discussion of the problems of bureaucracy and information control, see, in particular, Ludwig von Mises, Bureaucracy; Gordon Tullock, The Mathematics of Politics, pp. 100-132; and Randall Bartlett, The Economic Foundations of Political Power.

relative to those available in the private sector, or to advance proposals to limit the growth of the program. Speaking of the Social Security staff, past Chief Actuary of the Social Security Administration Robert Meyer said,

> Over the years most of the American staff engaged in program planning and policy development have had the philosophy--carried out with religious zeal--that what counts above all else is the expansion of the program.[1]

Early Threats to the Board's Survival: Long, Landon, Townsend, and the Supreme Court

The ability of the bureaucracy to have an independent effect on fiscal outcomes depends critically on the degree to which the bureau becomes isolated from competitive forces. The elimination of these forces, however, can be expected to be a gradual and imperfect process. With regard to the original old-age benefit (insurance) program, more than 40 percent of the working population were not originally covered by the program, and that portion of covered workers' incomes above the taxable ceiling could still be used freely to purchase private insurance. Moreover, the product being publicly provided had not yet been significantly differentiated from that which was being privately provided, and the new government program was still in the position of having to compete with existing programs for taxpayer dollars since the payroll tax would not be collected until 1937.

Also, the passage of the compulsory, federal old-age insurance program generated large uncompensated losses for those private firms

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[1]Myers, Social Insurance Expansionism, p. 29.

which had been providing substitute goods. These direct losses were only offset by expectations of windfall gains by the near elderly, the poor elderly, would-be employees of the new government agency and others. Old-age assistance grants (means-tested welfare) were to be payable in 1936, and payroll taxes were to be collected shortly thereafter, but old-age insurance benefits weren't scheduled to be paid until 1942.[1] In effect, there were no direct beneficiaries to the Social Security program as yet. Given these circumstances, the new program was particularly vulnerable to the forces of political competition, and the next general election was only months away.

The early years in the life of the new government bureau were, therefore, crucial to its resulting longevity and support; for indeed, it was during these years that the threat of competition--from both the private and public sector--was the keenest.[2] Indeed, at the same time the Social Security staff was embarking on a huge administrative undertaking, and to the alarm of officials who recognized the crucial importance of political (financial) support in the early years, external political and legal problems were developing. Almost immediately, the Board was faced with problems of funding, attacks during the 1936 election, continued pressure from the Townsend movement, and most importantly, serious constitutional questions; each of which severely constrained the Board's information generating capacity from 1935 to 1937.

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[1]The lump-sum refund and death benefits were payable in 1936.

[2]In his theory of bureau evolution, Downs refers to an "initial survival threshhold" that the new bureau must surpass. See Anthony Downs, Inside Bureaucracy, pp. 7-10.

The Social Security Board's activities were inhibited immediately when funds failed to be appropriated by Congress for its first fiscal year. Since no payroll taxes had been collected yet, the Board had to rely on Congressional appropriations from general revenues. At the outset, however, no funds were made available as a filibuster by Senator Huey Long (D.-La.) prevented the passage of a deficiency bill before Congress ended in 1935.[1] The board was forced to rely entirely on $112,000 from the Department of Labor, initially intended for the Works Project Administration, and a staff borrowed from the "demobilizing National Recovery Administration and other sympathetic agencies."[2] By June of 1936, the Board was funded for the 1937 fiscal year, but with 20 percent less than requested.

In 1936, only months after the Social Security Act was passed, the old-age insurance titles of the Act became a major election issue. Conservatives, led by Republican presidential nominee Alf Landon, attacked New Deal legislation as communistic and singled out Social Security as a key political issue. Governor Landon described the old-age insurance program as "unjust and unworkable,"

> And to call it "social security" is a fraud on the working man . . . The savings forced on our workers is a cruel hoax . . . To get a workable old-age pension plan, we must repeal the present compulsory insurance plan.[3]

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[1]McKinley and Frase, Launching Social Security, p. 18.

[2]Ibid., p. 29.

[3]Text of address by Governor Landon, The New York Times, September 27, 1936, pp. 1-2, cited by Daniel S. Sanders in The Impact of Reform Movements on Social Policy Change: The Case of Social Insurance (Fair Lawn, New Jersey: R. E. Burdick, Inc., 1973), p. 89.

Landon's remarks had an immediate impact on the Social Security Board and its role in "public relations."

> Chairman Winant replied with a dramatic resignation that permitted him to rush to the open political defense of the system . . . . The Board broke loose from the inhibitions that had largely paralyzed the work of the Informational Service since the AAA [Agricultural Adjustment Act] court decision. Leaflets and moving picture films intended to educate the people for the post election registration effort were brought out of hiding and given to the public with a free hand. The Board and its staff, in the last weeks before the election, vigorously co-operated with the Democratic party and the labor unions in getting out publicity in defense of the system.[1]

Trying to wage a campaign against the Social Security program, against a backdrop of many other politically popular relief and employment programs that had been created by Roosevelt, proved to be a large undertaking and conservative opposition was not made effective. Roosevelt won the 1936 election with 60.7 percent of the popular vote.[2] Nonetheless, changes in the program were forthcoming.

In addition to conservative opposition to the insurance provisions of the Social Security Act, the Social Security Board faced continued pressure from the Townsend movement.[3] On December 11, 1935, Edwin Witte, Executive Director of the CES, wrote Merrill Murray, Associate Director of the Bureau of Unemployment Compensation,

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[1]McKinley and Frase, Launching Social Security, pp. 29-30. The AAA Supreme Court decision generated a great deal of concern over the constitutionality of the Social Security Act.

[2]Arthur M. Schlesinger, The New Deal in Action: 1933-1939 (New York: The MacMillan Company, 1940), p. 41.

[3]Recall that the Townsend Plan proposed making large gratuitous transfers to all elderly persons, regardless of their income and work status.

> In the last three months I have become more concerned than ever with the Townsend plan. There is no doubt that this movement has made tremendous headway. The battle against the Townsend plan has been lost, I think, in pretty nearly every state west of the Mississippi, and the entire Middle Western area is likewise badly infected. At this time, the Republican party organization is at least flirting with the Townsendites, and I think it is mighty significant that not one of the major business organizations of the country has attacked the plan.[1]

As late as 1938, the Townsend movement was still strong. As an indication of its continued strength, more than ninety Republicans who had "indicated some commitment" to the Townsend plan were elected to Congress in 1938, more than one-half of the total number of Republicans in Congress.[2] It may have been the case that rather than advocating the Townsend plan, conservatives simply hoped to form a coalition with extreme income redistributionists in an effort to abolish the old-age insurance title. Nonetheless, the Townsend plan remained a threat as evidenced by a letter written in 1938 to Abraham Epstein, early social insurance advocate, in which Witte said,

> More and more it is becoming clear that the next major election issue in relation to Social Security is whether we want the Townsend plan or not . . . . The real issue is between the Social Security Act and the Townsend Plan.[3]

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[1]Witte is quoted in McKinley and Frase, Launching Social Security, p. 11, n. 14.

[2]Daniel Sanders, The Impact of Reform Movements, p. 140.

[3]Ibid. As an indication of the extent to which the Townsend Plan had gained national attention, a Gallup Poll in 1939 indicated that, out of the persons surveyed, 95 percent knew of the Plan, 40 percent favored it, and 49 percent knew the exact amount of the proposed transfers. This was contrasted with a general lack of understanding of the Social Security program--even the Gallup Poll questions were incorrectly stated. See Michael Schiltz, Public Attitudes Toward Social Security: 1935-1965, U.S. Department of Health, Education, and Welfare, Office of Research and Statistics, Research Report No. 33 (Washington, D.C.: Government Printing Office, 1970), pp. 34, 42.

The Constitutionality of the Social Security Act

Aside from the problems caused by a lack of funding, and other political pressures, organizational growth within the Social Security Board was slow for an additional reason. Most importantly, there was a growing concern over the constitutionality of the Social Security Act. Between 1935 and early 1936, seven out of nine New Deal acts were found unconstitutional, one of which had particular bearing on the Social Security Act--the Supreme Court's invalidation of the legal and financial power to maintain crop restrictions in the Agricultural Adjustment Act.[1] The adverse ruling had been based on the premise that the program had invaded states' rights. As a result, it was feared that although the Congress could appropriate funds for all types of general programs, the restrictions imposed on grant recipients in the Social Security Act might be found unconstitutional.[2] Edwin Witte, former Executive Director of the CES, responded that the "AAA decisions rendered very doubtful the constitutionality of Titles I, III, IV, V, and VI of the Social Security Act."[3]

With regard to the federal old-age benefit (insurance) program and the taxes imposed to finance it, constitutionality rested on whether

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[1] Arthur M. Schlesinger, New Deal in Action, p. 37.

[2] Edwin Witte, "The AAA Decision and the Constitutionality of the Social Security Act" (address presented January 20, 1936).

[3] Ibid. Titles I, III, IV, V, and VI pertained to federal-state public assistance programs; Titles II and VIII pertained to the tax-offset unemployment compensation program.

or not the Supreme Court judged that they did, in fact, constitute an "insurance" program.

> The only hope for these titles (II and VIII) is that the Court will find that they do not, in fact, establish an old-age insurance system. Doubtless the court will look at both titles when the tax imposed in Title IX [unemployment compensation] is challenged. Again the question will be whether this is a genuine tax levy or part of an unconstitutional plan to establish a federal insurance program.[1]

Because of these constitutional questions, early organizational growth of the Social Security bureaucracy was slow. As states doubted the constitutionality of the unemployment compensation titles, they hesitated to adopt state legislation. Therefore, there was little need to enlarge the Bureau of Unemployment Compensation. For similar reasons, by March 15, 1936, the Bureau of Old-Age Benefits had only three employees in addition to the director and his associate.[2] Since support for the old-age benefit program had relied heavily on the program's private insurance analogy, the Board was effectively paralyzed in its ability to market its output.

The Supreme Court Validation of the Act

As history has made clear, the Supreme Court found all of the titles of the Social Security Act constitutional in 1937. The sheer logic of the decisions, as well as its importance, are not obvious, however, without some grasp of the environment within which the Supreme Court was operating.

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[1]Ibid., p. 8.

[2]McKinley and Frase, Launching Social Security, p. 28.

Shortly before President Roosevelt was inaugurated for his second term in office on January 20, 1937, he announced that ". . . means must be found to adapt our legal forms and our judicial interpretation to the actual present national needs of the largest progressive democracy in the modern world."[1] On February 5, 1937, President Roosevelt proposed a reorganization of the federal judiciary in which he would have been empowered to appoint an additional Supreme Court justice to assist any justice who was seventy years of age or older.[2] As there were currently six out of nine Justices over seventy, the proposal would have empowered the President to increase the size of the Court to fifteen Justices. Despite the largest Democratic Congressional majority in history, bitter battles ensued in Congress over whether Roosevelt's plan was "packing" or "unpacking" the Supreme Court. Liberals joined with conservatives in opposing the President's plan.

Threats of Supreme Court reorganization had the immediate impact of laying constitutional questions open to the political arena. Indeed, it was during the flurry of activity surrounding the court-reorganization plan that each of the titles of the Social Security Act was validated. In 1937, conservative Justice Willis Van Devanter

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[1]Arthur M. Schlesinger, The New Deal in Action, p. 48. It is interesting to note that between 1790-1937, 40,000 cases had been tried by the Supreme Court, out of which only 76 acts had been found unconstitutional. Between March, 1933, and March, 1934, however, 12 New Deal Acts were found unconstitutional. See "The Supreme Court Controversy," The Congressional Digest, Vol. XVI, No. 3 (Washington, D.C.: A. G. and N. T. N. Robinson, 1937), pp. 75-76.

[2]For an interesting debate on President Roosevelt's reorganization plan, see "The Supreme Court Controversy," The Congressional Digest, pp. 65-76.

announced his plans to retire; and Senator Joseph Robinson, court-reorganization leader in the Senate, died. Between March 29, and May 24, 1937, the Supreme Court sustained the constitutionality of the second Frazier-Lemke farm mortgage law; a 1936 act conferring collective bargaining rights to railway employees; a minimum wage law in Washington; the National Labor Relations Board; as well as the old-age benefit provisions and unemployment compensation titles of the Social Security Act.[1]

The Supreme Court decision validating the old-age benefit titles of the Social Security Act was handed down on May 24, 1937. The nature of the decision is of considerable interest in light of the program's historical popularity as well as current debates over whether Social Security is, or ever has been, an insurance program, as the Social Security Administration has maintained, or a complex scheme to redistribute income, as skeptics suggest. Also, the nature of the decision is of considerable importance in understanding the transition of the United States from a country in which the federal government played a limited role in explicitly income redistributive programs to one which has become a relatively centralized "welfare state." The Roosevelt years alone witnesses a major change in the delineation of the rights of individuals vis-à-vis the collectivity.

Basically, the validation was based on a very strict interpretation of the Social Security Act--its purpose in print rather than in

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[1]Arthur M. Schlesinger, New Deal in Action, pp. 49-50.

fact. The original Social Security Act had been carefully drafted so that each title stood independently of one another. Should one title of the Act be found unconstitutional, the others stood on their own. Further, the tax and benefit titles of the old-age insurance provisions were carefully divorced from one another. The payroll taxes in Title VIII were designated "income taxes on employees" and "excise taxes on employers."[1] In a strict sense, the title simply provided two additional sources of federal revenues. Speaking of Title VIII, Justice Cardoza said there were

> . . . two different types of taxes, an "income tax on employees" and an "excise tax on employers" . . . . The proceeds of both taxes are to be paid into the Treasury like internal revenue taxes generally, and are not earmarked in any way . . . . These are true taxes, their purpose being simply to raise revenues . . . the proceeds are paid unrestricted into the Treasury as internal revenue collections, available for general support of the Government.[2]

Accordingly, the old-age benefits in Title II were to be financed by annual appropriations from general revenues. <u>In the original Social Security Act, there was no written provision for financing the program from the Title VIII payroll taxes, and there was no reference to the term insurance</u>. This was, of course, contrary to the intent of the law as expressed in the CES Report, Presidential statements, and Congressional hearings. It has been pointed out, however, that with

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[1]Social Security Act of August 14, 1935, Pub. No. 271, 74th Cong. [HR 7260].

[2]Opinion delivered by Mr. Justice Cardoza, S. Doc. No. 74, 75th Cong., 1st Sess., p. 30 (1937), cited in Marjorie Shearon, <u>Wilbur Cohen, The Pursuit of Power: A Bureaucratic Biography</u> (Washington, D.C.: Gray Printing Co., 1967), pp. 229-230.

few exceptions the Social Security Board avoided the use of the private insurance analogy until after the 1937 court decision.

Regarding the entire issue of constitutionality, Justice Cardoza said, "Needs that were narrow or parochial a century ago may be interwoven in our day with the well-being of our nation."[1] Preventing old-age need, he continued, was "plainly national in area and dimension." As such, benefit payments were likened to "gratuitous transfers."[2]

The Supreme Court decision validating the old-age benefit titles rested on an interpretation of the Social Security Act that was simply counter to the most fundamental popular understanding of the Act and, of course, counter to interpretations transmitted by Social Security officials over the years.

Early Pressures for Program Expansion.

Despite the 1935-1937 interlude in which constitutionality, funding, and political support were uncertain, mid-1937 marked a brighter future for the Social Security Board. By that time, the Social Security Act had been validated, President Roosevelt had been reelected, and Democratic majorities in Congress had swollen. The Democrats held 334 out of 435 seats in the House and 75 seats in the Senate compared to 17 held by the Republicans.[3] Moreover, the payroll tax was newly

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[1]U.S. Social Security Board, Annual Report: 1936-1937 (Washington, D.C.: The Social Security Board, 1938), pp. 8-9.

[2]Ibid. In line with the gratuitous transfer interpretation of old-age insurance benefits, note that old-age retirement benefits have never been taxable.

[3]Arthur M. Schlesinger, New Deal in Action, p. 41.

being collected thus bestowing upon voters entitlements to future benefit claims and creating vested interests in the program's maintenance. In short, the Social Security Board was in a more secure position from which to amass political support for expansion.

Immediately after the Act was validated, internal supply-side pressure for expansion ensued. On May 25, 1937, the day after the Supreme Court handed down its decision, Arthur Altmeyer, Chairman of the Social Security Board, addressed a group of social workers and announced:

> Passing the law is only, as it were, the "curtain-raiser" in the evolution of such a program. It is already possible to distinguish at least three phases of this evolution, each with its distinctive emphasis--first, the double barrelled job of setting up administrative machinery and of getting it into operation; second, the development and integration of administration and services within the present framework; and third, further expansion to liberalize existing provisions.[1]

From that time onward, expansion and liberalization were the keynotes of statements and policy proposals heralded by social security officials, proposals that frequently predated broader based citizens' demand by decades.

By 1937, an advisory council had been appointed to study recommended changes in the program and, in 1939, the most radical overhaul in the history of the program took place.

The enactment of the 1939 amendments warrant particular attention not only because they changed so markedly the nature and resulting

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[1]Arthur J. Altmeyer, "Progress and Prospects Under the Social Security Act" (address before the National Conference of Social Workers, May 25, 1937, unpublished addresses by A. J. Altmeyer, Library, U.S. Department of Health, Education, and Welfare), p. 4.

growth of the compulsory old-age insurance program, but also because they shed light on the political forces that would continue to come to bear on the new government program. Despite the fact that Social Security was originally envisioned as a permanent, relatively well constrained program with limited objectives, it also represented a mechanism through which Social Security officials, along with coalitions of high demand special interest groups, could employ the political process to redistribute income and reduce effective constraints on such activity. The sources and types of policy recommendations, the stands of key lobby groups, and the issues of political debate in 1939 were the same as in 1977. How should benefits be distributed? Who should bear the cost of the program? How should the program be financed? The resolution of each of these questions in 1939 is vitally important to the rapid growth and proliferation the program has since experienced.

The first formal initiative toward amending the Social Security Act was taken by the Senate Finance Committee in 1937 when it authorized the committee chairman to appoint a three Senator committee--the Senate Special Subcommittee on Social Security (Senators Pat Harrison, Harry Byrd, and Arthur Vandenburg)--to join with the Social Security Board in appointing an Advisory Council on Social Security.[1] The advisory council was to be delegated with the responsibility of studying and making recommendations on the following issues:

(1) Extending compulsory coverage.

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[1]"Congress Looks at Social Security," <u>The Congressional Digest</u>, p. 139.

(2) Commencing benefit payments before January, 1942.

(3) Increasing benefits payable to early retirees.

(4) Extending benefit coverage to survivors.

(5) Increasing tax rates less rapidly than scheduled.

(6) Providing disability benefits.

By May, 1937, the first Advisory Council on Social Security was appointed.[1]

Over the years, the recommendations of the regularly appointed twelve member advisory councils have been given serious consideration in Congress and have formed the backbone of major policy changes. For that reason, the composition and output of these councils is of interest. What is observed with regard to both is that "citizens' advisory councils" have historically served to buttress the demands of expansionists within the bureaucracy rather than to inject alternative views. Notably, despite the apparent balance of interests between "employees, employers, and citizens," advisory councils have been staffed predominantly by social insurance advocates and high demand special interest groups. With the exception of the most recent advisory council (1975), all councils have included influential members of the CES, some of whom went on to become staff members of the Social Security Board. All

[1]Advisory councils were appointed by the Senate Committee on Finance in 1947, and by the Department of Health, Education, and Welfare (HEW) in 1953. The amendments of 1956 contained a provision for the periodic appointment of an advisory council to study financing OASDI. Under this provision, the Secretary of HEW appointed a council in 1957 and 1963. From 1966, onward, advisory councils have been appointed each five years. See Robert Myers, Social Insurance and Allied Government Programs, pp. 58-59.

councils have been effectively dominated by advocates in the fields of organized labor, social work, and social reform. No less important in explaining the coincidence of interests between council members and Board members is the fact that the information upon which council members have based their decisions on highly complex policy issues has been provided by Social Security officials. It is hardly coincidental, therefore, that the recommendations proposed by advisory councils have infrequently diverged from those endorsed by the Board. In essence, advisory councils have operated not so much as demand-side monitors of the bureau as vehicles for transmitting the Board's policy proposals.

The 1938 Advisory Council was no exception. Indeed, it was said that

> Arthur Altmeyer, as Chairman of the Social Security Board, utilized skillfully the advisory council and the reformers and interest groups represented in it to further the movement.[1]

"Employees" were represented by six officials from organized labor. Among the twelve members who represented the "public," Douglas Brown, Edwin Witte, and Paul Douglas were all former members of the CES. Witte and Brown had subsequently become consultants to the Social Security Board, while Douglas had become a staff member. Finally, "employers" were represented by six top level officers in private industry. Two of the three representatives of employers, Gerald Swope

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[1]Daniel Sanders, The Impact of Reform Movements, p. 91. Altmeyer was the Chairman of the Social Security Board from 1936-1946. After the Federal Reorganization Act of 1946 dissolved the Social Security Board, he was designated the Commissioner of Social Security, and maintained that position until he resigned in 1953.

and Marion Folsom, were both former members of the CES; while Marion Folsom later became the Secretary of the Department of Health, Education and Welfare in the Eisenhower Administration.[1]

On April 28, 1938, during the period the council was meeting, President Roosevelt transmitted to the Social Security Board a request that the Board consider liberalizing the old-age benefit program.[2] Consideration was to include, he suggested, a list of issues coincidental with those being studied by the advisory council. In January of 1939, a month after the advisory council reported, President Roosevelt addressed Congress making recommendations concerning the Social Security program. In his message, he said,

> We would be derelict of our responsibility if we did not take advantage of the experience we have accumulated to strengthen and extend its [the Social Security Act's] provisions.[3]

At this time, the President endorsed and transmitted the Social Security Board's recommendations, implicitly endorsing the recommendations of the advisory council. In particular, he endorsed early and liberalized benefit payments, benefits to dependents and survivors, extended coverage, and larger federal grants to states for public assistance.

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[1]For a list of members, see U.S. Advisory Council on Social Security, Final Report, December 10, 1938 (Washington, D.C.: The Social Security Board, 1938).

[2]U.S. Social Security Board, Annual Report: 1935-1936 (Washington, D.C.: The Social Security Board, 1937), p. 17.

[3]"Congress looks at Social Security," Congressional Digest, p. 140.

Table 25 compares the recommendations proposed by the 1938 Advisory Council with those made by the Social Security Board. The recommendations are of particular interest as they predated many of the amendments that were to be enacted over the next four decades.

It is clear that the proposed changes, as indicated in Table 25, were designed to change markedly the nature of the Social Security Program.[1] Tax rates and the taxable ceiling, as set in 1935, were not to be altered, while benefits were to be extended dramatically--the notion of the fully funded program was to be dismissed. Benefit formulas were to be more heavily weighted toward lower income persons and those with shorter periods of covered employment to enhance the redistributive impact of the program. Finally, individual worker equity was to be largely set aside for the attainment of "social goals": family protection and income redistribution.

Hearings on amending the Social Security Act commenced on February 1, 1939, in the House Ways and Means Committee.[2] Throughout the hearings, and in public statements, the nature of the old-age benefit program, as well as the details of provision, were debated. Critics included fiscal conservatives who opposed the very nature of the Social Security program and preferred, for economic and philosophical reasons,

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[1]Keep in mind that these comprehensive changes in Social Security were both recommended and enacted prior to the time any monthly payments were made under the old-age insurance program.

[2]For the legislative details and debates surrounding the proposed 1939 amendments, see "Congress Looks at Social Security," Congressional Digest, pp. 133-160. For a more general discussion, see Daniel Sanders, The Impact of Reform Movements, pp. 82-97.

TABLE 25

RECOMMENDATIONS MADE BY THE 1938 ADVISORY COUNCIL AND SOCIAL SECURITY BOARD ON AMENDING THE OLD-AGE INSURANCE PROGRAM (AND DATE OF ENACTMENT)

Recommendations and description
Benefits:
Begin monthly benefit payments in January, 1940, rather than in January, 1942 (1939)
Increase benefits for early retirees (1939)
Calculate benefits on the basis of average covered wages rather than on the basis of total covered wages (1939)
Establish new beneficiary categories:
Dependent wives (1939)
Widows (1939)
Widows with children (1939)
Extend coverage to:
Persons older than sixty-five (1939)
Agricultural labor (1950)
Domestic servants (1950)
Non-profit organizations (on an elective basis--1950)
Instrumentalities (on an elective basis--1954)
Financing:
Supplement financing through non-payroll taxes (only used on a very limited basis to finance gratuitous benefits to Japanese internees (1972), persons older than seventy-two (1966) and to survivors of World War II veterans (1942).

TABLE 25--Continued

Recommendations and description
Additional Recommendations Made by The 1938 Advisory Council:
Establish a contingency fund, designated a "trust fund," and appoint a board of trustees (1939). Automatically appropriate payroll tax receipts to the trust fund (1939).
Reduce future costs of the program by reducing future benefits to single annuitants (1939)
Introduce disability insurance benefits (1956)
Eliminate the 3-1/2 percent lump sum refund (1939) and restrict the 3-1/2 percent lump sum death payments (1939)

SOURCES: "Congress Looks at Social Security," The Congressional Digest, Vol. XVIII, No. 5 (Washington, D.C.: A. G. and N. T. N. Robinson, 1939), pp. 133-160.

U.S. Department of Health, Education, and Welfare; Social Security Administration, History of the Provisions of OASDHI: 1935-1973 (Washington, D.C.: Government Printing Office, 1974), p. 7.

reliance on voluntary organizations and private enterprise. More moderate conservatives supported the public assistance titles of the Act, but advocated eliminating the insurance aspects. Those who endorsed the program in broad outline but advocated expansion included the elderly, organized labor, social reformers, and others who had been involved in creating and carrying out the Social Security Act.[1] Finally, more extensive income redistribution was advocated by the Townsend uniform-pension movement and followers of Abraham Epstein.

With varying degrees of importance, issues of debate in 1939 ranged from philosophical questions of individual liberty to political questions of income redistribution, to the apparently practical question of how to fund the program. Many conservatives recognized that complete "economic security" was incongruous with the maintenance of personal liberty. An article presented to the Committee on Ways and Means warned against too rapid expansion of the Social Security system.

> Where would you rather live? In the America of today, where there is liberty for all but not security for all, or in Germany of today, where there is alleged security for all, but liberty for none?[2]

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[1]Early Keynesians were also among the group that advocated an expansion of the program. See Daniel Sanders, Impact of Reform Movements, p. 83. Among others, Edwin Witte (Executive Director of the CES) later endorsed the use of Social Security for macroeconomic stabilization. Specifically, he advocated varying the payroll tax rate with the level of employment, and paying benefits in order to "sustain purchasing power . . . regardless of the state of the social security funds." Edwin Witte, "Social Security--1948," in Saving American Capitalism: A Liberal Economic Program, ed. by Seymour E. Harris (N.Y.: Alfred A. Knopf, 1948), pp. 309-310.

[2]From text of article by Roger Babson in "Congress Looks At Social Security," Congressional Digest, p. 156.

Liberal sentiments were expressed quite aptly by Abraham Epstein when he criticized the prevailing fiscal conservatism inherent in financing the program upon actuarial principles. Appearing before the Advisory Council on Social Security and expressing the views that many social insurance advocates supported implicitly, the leading advocate of social insurance-for-income redistribution said,

> The underlying defect of the present system of old-age insurance embodied in the Act lies in the fact that although intended as a social insurance measure, it completely violates what has been known as social insurance for the past 50 years . . . . In social insurance it matters little whether the people bearing the risk pay the contributions themselves. What is of prime concern is that those who suffer most should receive the greatest protection. Since its chief aim is to accomplish socially desirable ends, the premium rates are dictated by social policy, not by the actuary.[1]

Townsend, still calling for guaranteed uniform pensions to all of the elderly population, appeared before the Committee and called the existing program "the height of absurdity."[2] Social Security staff, individual members of the advisory council, and President Roosevelt generally claimed that the program was sound yet in need of improvement through expansion.

On a more practical note, a great deal of debate centered around the appropriate size of the fund. The major issue was whether the program should be on a full "reserve" basis, as contemplated in the original Act, or on a "pay-as-you-go" basis, possibly with federal

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[1] Statement by Abraham Epstein, December 10, 1937, cited in Daniel Sanders, The Impact of Reform Movements, pp. 91-92.

[2] From statement by Frances Townsend in "Congress Looks at Social Security," Congressional Digest, p. 158.

contributions. It is interesting to note that up until this time, the Social Security Board had consistently upheld the reserve principle.[1] In their first annual report, they reiterated the clear intent of the original law and their responsibility to: (1) provide limited coverage and a close benefit-earnings link, and (2) finance the program on the reserve principle. At that time, they recognized only one alternative to the reserve principle--current financing out of general revenues. For that reason, they concluded that,

> The question of whether we should have a reserve system or a pay—as-you-go system cannot be decided without considering the whole theory of the present plan, particularly as it concerns the interrelationship between earnings and benefits.[2]

In their second and third annual reports, the Board emphasized the need to restrict benefits to those persons who paid the tax, therefore, denying a government contribution. Also, they stressed the intent of the 1935 Act. The reserve account, they said, should be large enough to finance all promised benefits with the combined tax rate no higher than 6 percent.[3]

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[1]The Social Security Board upheld the reserve principle in their first, second and third annual reports (reports through fiscal year 1937-38). In fact, they recognized that without a funded program, "it would be possible for succeeding generations to meet obligations accruing through this early period only by means of a much higher tax rate than the maximum in the present law, or by a large government subsidy." U.S. Social Security Board, Annual Report, 1936-1937, p. 23. See also, The Annual Reports for 1935-1936, p. 14, and for 1937-1938, pp. 36-38.

[2]U.S. Social Security Board, Annual Report: 1935-1936, p. 14.

[3]U.S. Social Security Board, Annual Report, 1937-1938, p. 37.

It seems unquestionable that mounting pressure to quickly pay out benefits, plus a desire to pay out benefits larger than scheduled, forced (or permitted) the Board to re-evaluate the issue of funding versus pay-as-you-go. Altmeyer, Chairman of the Social Security Board, characterized the issue as "consisting largely of 'sound and fury, signifying nothing,'" since the method of financing the system would only affect future generations, when "it is impossible to properly assay the conditions."[1] By fiscal year 1938-1939, Social Security officials had rejected the reserve principle, endorsing all of the recommendations of the advisory council, including the recommendation to finance the program with a "contingency" fund.[2] It appears most likely that the merits recently accorded the pay-as-you-go system of social insurance arose initially out of the need to rationalize what was politically unlikely to be prevented. By 1939, there were already some $1.7 billion ($6.6 billion) in the trust fund that were not yet being distributed in monthly benefits.[3]

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[1]Arthur J. Altmeyer, "Future of Social Security in America" (address before the Institute of Public Affairs, University of Virginia, July 17, 1937), p. 8; and "Progress and Prospects under the Social Security Act" (address before the National Conference of Social Workers, May 25, 1936), pp. 9-10.

[2]Recommendations detailed in U.S. Social Security Board, 4th Annual Report (Washington, D.C.: Federal Security Administration, 1940). A contingency fund is one large enough to cover current expenditures with allowance for unexpected changes in cash flow.

[3]U.S. Department of Health, Education and Welfare, Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), p. 61. From an alternative point of view, the 1938 advisory council remarked that earlier benefit payments would have the "social advantage

The Social Security Board was not alone in its desire to expand and redirect the program. External pressure for expansion and redirection were exerted, most notably, by Epstein and the American Association for Old-Age Security, the labor movement, and the Townsend movement. Also, from the point of view of many voters--the elderly, the poor, dependents and survivors--the proposed changes provided a lucrative package. Benefits were to be paid earlier; they were to be liberalized; and whole new beneficiary categories were to be introduced to provide permanent benefits to many people who had never paid any taxes. Importantly, taxes were not scheduled to be increased. Having little or no experience with government "promises" of the type implied by an old-age insurance program, voters had little reason to believe that costs would be increased dramatically in the future.[1]

The Lack of Organized Opposition

As has been the case historically, fiscal conservatives had little organized representation or impact on policy. This was partly due to the fact that typically conservative business interests were in an unusually poor bargaining position when the issue at hand was social justice, welfare, or security. They were easily dismissed as being self-interested "capitalists." This was particularly true in the 1930's

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in enhancing public understanding of the method of contributory social insurance." U.S. Advisory Council on Social Security, Final Report, December 10, 1938, p. 37.

[1]Note that the maximum taxpayment in 1939 was $60 ($233) per year, scheduled to peak at $180 ($700) in 1949. In 1976, the maximum tax payment had reached $1,790, more than a 155 percent increase, in real terms, over that which was planned for 1949.

as there was yet no organized conservative intellectual movement.[1] Secondly, a screening process controlling who shall make statements at Congressional hearings or to advisory councils, and the timing of these statements, has not worked in favor of conservative representation. Thirdly, many persons who have been conservative in general, become less so when the issue at hand is dollar transfers or subsidies. Many special interest groups, including the elderly, have therefore supported expansionary policies (in terms of benefits) hoping to transfer the cost burden to others.[2] Finally, an asymmetry in the cost of obtaining information on the likely impact of policy changes has tended to work against active lobbying by taxpayer groups. As a result, public discussions on amending the Social Security Act have normally been dominated by supporters of two types--moderates and expansionists. The latter group, backed by Social Security officials, has been in the better tactical position.

The last point regarding the costs of gathering information is particularly important because it helps explain why lobby activities and, therefore, Congressional voting decisions have typically been expansionary, and why advocates of fiscal restraint have not been more effective in constraining the growth and redirection of Social Security.

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[1] George Nash, The Conservative Intellectual Movement in America Since 1945 (N.Y.: Basic Books, Inc., 1976). Indeed, it was the progressive intellectuals from Wisconsin that created and sustained the entire social insurance movement.

[2] Similarly, congressmen with typically conservative voting records have not infrequently endeavored to reduce oppressive state welfare expenditures by dispersing these tax costs through an expanded social insurance system.

Foremost, there has existed a clear asymmetry in the cost of obtaining information on the impact of policy changes between beneficiary groups and taxpayer groups. The self-interested beneficiary (the elderly, near-elderly, and public employee) need only observe the magnitude and implied changes in the magnitude of his monthly benefit, or employment opportunities, in order to assess the desirability of any given policy change.

The costs of obtaining information for the self-interested taxpayer, on the other hand, are significantly, if not prohibitively, higher, depending upon his age.[1] How could the young covered worker possibly assess the likely impact of a policy change on benefit payments to be received forty years hence, or his share of the implied future tax payments required to finance them? He may rationally either abstain from gathering information or rely on information made available by Social Security officials--those least motivated to constrain expansionary program changes.[2] Moreover, to the extent that worker-taxpayers do not perceive the full cost of the program by misperceiving the incidence of the employer's tax share, the incentive for

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[1]This would not be true under a fully-funded system. The differences between the information requirements associated with a funded versus a pay-as-you-go system are discussed infra, pp. 320-321.

[2]For a discussion of rational ignorance as a response to costly information, see in particular, Anthony Downs, <u>An Economic Theory of Democracy</u>.

him to actively seek information and lobby against costly expansions is further reduced.[1]

The impact of information asymmetry on actual policy decisions is compounded by the fact that there has also existed an asymmetry in the cost of formalizing or transmitting demands between beneficiary groups and taxpayer groups. Social Security officials, for example, are federally funded to devise and publicize policy recommendations; and the elderly may be expected to have a relatively low opportunity cost of their time. Not surprisingly, voter participation rates among both groups have tended to be quite high.

How do these factors influence Congressional voting decisions? In the presence of costly and imperfect information on voter demands with regard to complex policy issues, the rational Congressman can be expected to operate on the basis of the most readily available information on voter demands. Whether it be the bureau that is funded to generate this type of information, or organized lobby groups, these are the active participants in the collective choice process to whom elected representatives generally respond.

Moreover, because of the complexity of most Social Security bills and the nature of the political reward structure, elected representatives have rationally found themselves in the position of voting on the basis of "key" issues such as benefit increases to subgroups of

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[1]Likewise, to the extent voters believe incorrectly that Social Security is fully-funded, their opposition to current period expansion (tax increases) may be further reduced as this would simply reflect a collective decision to "save" more federally.

voters. Benefit increases, as effective means of program expansion, can be effected directly by across-the-board benefit increases, or indirectly through "technical changes" in benefit formulas, reductions in eligibility requirements, the introduction of new beneficiary categories, etc. These benefit increases are clearly perceived and lobbied for by direct beneficiaries, who quite often bear a small proportion of the additional cost, and facilitate the passage of a complex array of technical changes to which they are tied.[1] In essence, since tax costs are so widely dispersed, and in some cases can be transferred to a minority of taxpayers through taxable ceiling increases, there has rarely been any effective opposition to complex program changes when accompanied by benefit increases.

Once one recognizes the incentives of voters, their elected representatives, and public employees; and the power of a coalition endorsing program expansion and redirection which included the Social Security Board, the Advisory Council, the Townsend Movement, the American Association for Old-Age Security, and organized labor, the fact that the recommendations of the Social Security Board were passed largely in their entirety in the 1939 Amendments should come as no surprise.

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[1]Most complex amendments to the Social Security Act have, in fact, been tied to politically popular benefit increases. This was particularly true in the 1960's and early 1970's. For a more detailed discussion of the incentive of bureaucrats and other advocates of program expansion to tie several seemingly unrelated amendments in a single legislative package, see supra, pp. 197-201.

The Amendments of 1939: Major Redefinition and Expansion

Most of the important changes in the Social Security Act, as enacted in 1939, are reflected in the benefit schedule as depicted in Table 26. The addition of survivors' and dependents' benefits along with a more heavily weighted benefit formula were among the most profound changes in the program. Each of these amendments were implemented exactly as proposed by the Social Security Board.[1]

As indicated in Table 26, the 1939 amendments had the effect of drastically altering the direction of the program even before any monthly benefits had been paid. No longer were two workers with the same earnings histories entitled to the same benefits. Instead, family status at the time of retirement became a most important determinant of benefit levels. Additionally, workers who would retire early in the life of the program, particularly those with low average earnings, were favored by a new benefit formula that was weighted toward low average earnings.

According to the new benefit schedule, benefits for future retirees were actually reduced for single annuitants while benefits for early retirees, whether married or single, were increased. Regardless of earnings, a married couple who retired early in the life of

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[1]For a detailed description of the 1939 amendments, see John D. Corson, "Explanation of Federal OASI under the Social Security Act Amendments of 1939," Bulletin No. 17, August 26, 1939, in Director's Bulletin of Progress: 1938-1940 (unpublished memos by Director of Bureau of OASI, Library, U.S. Department of Health, Education, and Welfare). See also, U.S. Social Security Board, 5th Annual Report, 1939-1940.

TABLE 26

ILLUSTRATION OF MONTHLY OLD-AGE BENEFITS UNDER
THE 1935 ACT AND AS AMENDED IN 1939[a]

Years of coverage	1935 Act	1939 Amendments	
		Single	Married
	AVERAGE MONTHLY WAGE OF $50		
3	-b-	$20.60	$30.90
5	$15.00	21.00	31.50
10	17.50	22.00	33.00
20	22.50	24.00	36.00
30	27.50	26.00	39.00
40	32.50	28.00	40.00
	AVERAGE MONTHLY WAGE OF $100		
3	-b-	$25.75	$38.63
5	$17.50	26.25	39.38
10	22.50	27.50	41.25
20	32.50	30.00	45.00
30	42.50	32.50	48.75
40	51.25	35.00	52.50
	AVERAGE MONTHLY WAGE OF $150		
3	-b-	$30.90	$46.35
5	$20.00	31.50	47.25
10	27.50	33.00	49.00
20	42.50	36.00	54.00
30	53.75	39.00	58.50
40	61.25	42.00	63.00

TABLE 26--Continued

Years of coverage	1935 Act	1939 Amendments	
		Single	Married
AVERAGE MONTHLY WAGE OF $250			
3	-b-	$41.20	$61.80
5	$25.00	42.00	63.00
10	37.50	44.00	66.00
20	56.25	48.00	72.00
30	68.75	52.00	78.00
40	81.25	56.00	84.00

SOURCE: "Congress Looks at Social Security," The Congressional Digest, Vol. XVIII, No. 5 (Washington, D.C.: A. G. and N. T. N. Robinson, 1939), p. 145.

[a]Below dashed line, 1939 amendments actually reduced benefits for single annuitants.

[b]Benefits not payable until after five years of coverage.

the program was "promised" more than double the amount a single annuitant had been previously scheduled to receive.[1] Benefits for married couples who were to retire late in the life of the program hardly exceeded the amount a single annuitant had been scheduled to receive.

Aside from increasing benefits for many people, paying benefits earlier than planned, and freezing the 2 percent tax rate, additional changes were made in the wording of the Act to enhance the program's marketability. The Old-Age Reserve Account was renamed the Old-Age and Survivors' Insurance Trust Fund; old-age benefit payments were renamed "insurance" benefits; and Title VIII income and excise (payroll) taxes were repealed and replaced by "insurance contributions" in the Federal Insurance Contributions Act (FICA), part of the Internal Revenue Code. Also, a three member "Board of Trustees" (Secretary of Treasury, Secretary of Labor, and Chairman of the Social Security

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[1]It is interesting to note that by abandoning the fund, the accumulated $1.7 billion ($6.6 billion) could be exploited to give more generous benefits to all other covered workers, at all income classes. Regardless of income class, the married worker who would retire with only three to five years of coverage had benefit increases scheduled to exceed 100 percent. Benefit increases then scaled down reaching less than 5 percent for married workers retiring forty years hence. The largest gains were made by persons with average monthly earnings less than $100, but median covered monthly earnings in 1940 were only $62. Indeed, the nature of the pay-as-you-go system permitted a postponement of these costs well into the future. For monthly earnings data, see Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 67.

The "discrimination" against married women, eligible for benefits as retired workers, has existed since the 1939 Amendments introduced wives' benefits.

Board) was created to oversee, safeguard, and make recommendations on the use of the fund. In President Roosevelt's words, the millions of people in covered employment "may be likened to the policy holders of a private insurance company."[1] The delay in implementing this terminology earlier was, of course, the likelihood that it would render the Act unconstitutional.

The irony is that insurance terminology was introduced into the Social Security Act at the same time the private insurance analogy was rendered no longer applicable. The private insurance analogy has not been applicable since 1939 for three reasons.[2] First, unlike the Social Security program, a private insurance company in a competitive setting must operate in a manner that ensures individual equity.[3] In

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[1]Text of President Franklin D. Roosevelt's Message to Congress, January 16, 1939, in "Congress Looks at Social Security," Congressional Digest, pp. 140-141.

The voluntary private insurance analogy was also used in 1881 by Otto von Bismarck when he spoke of early German social insurance proposals; see supra, p. 215.

[2]In fact, the Supreme Court declared that covered employees had a "non-contractual interest that cannot be soundly analogized to that of a holder of an annuity, whose rights to benefits are bottomed on his contractual premium payments." Flemming vs. Nestor, 363 U.S. 603, 1960.

[3]Eveline Burns, an outspoken proponent of social insurance, described the differences between private and public insurance most succinctly when she said,

> "It is no longer a matter of offering each individual a choice as to how much protection he will buy at the range of premiums yielded by the calculations of the actuary. Unlike the private insurer the government is not restricted by the fear of competition, and can safely offer differential benefits for uniform contributions, or discriminate against certain insured groups . . . . In private insurance, the purpose is to make a profit out of selling people something they want. The essential

order to receive larger benefits, say for the protection of additional family members, higher premiums must be paid in the private sector. Holding lifespan and retirement age constant, workers with the same earnings and premium payment histories are generally assured of the same rate of return in the private sector. Likewise, the relationship between benefits and premiums or the rate of return on one's investments, would never be systematically more favorable for the recently covered elderly or poor. Second, the 1939 amendments made it clear that there were no "contractual claims to earned benefits," as certain types of benefits had been eliminated statutorially. Third, concerning the financing of the insurance program, Social Security was no longer intended to be on a funded reserve basis.

Impact of Program Changes on Resulting Redirection and Growth

Each of these factors must be considered significant in influencing the future course of the old-age insurance program. The creation

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criterion governing every decision as to terms and conditions is its effect upon the continuing existence of the company. Obviously, if the company is to continue operating in a competitive world, it must offer services that people think is worthwhile to pay for and run its affairs in such a way that the guarantees offered will be honoured when due . . . . In social insurance, the purpose is different."

See Eveline M. Burns, "Private and Social Insurance and the Problem of Social Security," in Analysis of the Social Security System: Hearings before a Subcommittee on Ways and Means, House of Representatives, 83rd Cong., 1st Sess., No. 38458 (Washington, D.C.: Government Printing Office, 1954), p. 1475.

For more discussion of the differences between private insurance and social insurance, see Joseph Pechman, Henry Aaron and Michael Taussig, Social Security: Perspectives for Reform (Washington, D.C.: The Brookings Institute, 1968), pp. 69-77, and Robert Myers, Social Insurance and Allied Government Programs, pp. 8-10.

of a benefit formula that generated a distribution of benefits that would increasingly diverge from the distribution that would have arisen in the private sector had a twofold effect. First, by differentiating the product produced in the public sector from that privately produced, competition was reduced beyond the degree attributable simply to compulsory purchase of the publicly provided product. To the extent the general populace continued to believe the program was funded and therefore producing a good comparable to that produced privately, such a change would increasingly place the private sector at a comparative disadvantage in providing old-age insurance to the near-elderly and low-income elderly, particularly those with families. Second, as the individual equity benchmark was replaced by "social adequacy" goals, what quantitative standards could be used to constrain the extent of redistribution? Indeed, once the distribution of benefits was divorced from the work of the actuary, in Epstein's words, and placed in the hands of majority voting, the resulting distribution need bear little relation to that which might have been considered "equitable."[1]

The impact of the fact that the 1939 amendments bestowed fairly significant uncompensated losses on certain covered workers can be viewed similarly. In essence, it made it clear that the rules of what had appeared to be a permanent game had been changed and could be changed again in the future by effective coalitions of voters. The

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[1]For more on the political difficulties associated with constraining a social insurance program designed to provide "adequate" incomes for the elderly, see F. A. Hayek, The Constitution of Liberty, pp. 285-305.

1939 amendments not only reduced the expected value of future benefit streams for the single annuitant, but also for workers who would not eventually become eligible for benefits, and workers who would die without eligibile survivors. Specifically, the lump sum benefit equivalent to the workers' tax payments plus interest (benefits not less than 3-1/2 percent of total covered wages) were no longer refunded to individuals at the age of sixty-five who had not become eligible for monthly benefits--the "money-back guarantee" was repealed. Also, the 3-1/2 percent lump sum death payment was restricted to six times the individual's primary insurance amount--a significant reduction for many.[1] As a result of these changes, the Social Security Board guaranteed itself sources of revenue on which it owed no return.[2] By so

[1]During fiscal year 1938-1939 alone, there were 93,000 claims for refunds at age 65, totalling $6.5 million ($25.2 million); and 119,000 claims for death benefits, totalling $7.8 million ($30.3 million). The cumulative total of these benefit payments was $20.2 million ($78.6 million). U.S. Social Security Board, 4th Annual Report, 1938-1939, p. 29.

[2]In other words, if a person pays taxes periodically over his working life but does not, at age 65, have enough covered quarters, or high enough wages, he may get nothing back from the Social Security program.

Also, while the 1939 amendments provided refunds to workers who had paid more than the maximum tax payment because of having more than one job, there was no such provision for the employer's share of the tax. As is the case today (1977), there is no refund of the employers' share of taxes paid on workers' earnings above the taxable ceiling, accrued on second jobs. For example, suppose a worker earns $16,000 in one job and $5,000 in a second job; and further assume the combined tax rate is 10 % and the maximum taxable earnings are $15,000. In this case, the workers would be taxed on earnings of $15,000 in his first job, paying an employee tax of $750, and taxed on all $5,000 in his second job, paying a refundable employee tax of $250. The employers would be taxed equivalently, but without the refund provision. If, as many economists believe, the worker pays the full tax, he has doing, the redistributive potential inherent to the new government program was exploited. Surprisingly enough, the misconception that workers have contractual rights to earned benefits had not yet been fully erased in the early 1970's.

Finally, the importance of switching in 1939 from a funded program to a pay-as-you-go system of social insurance is only recently being recognized. In essence, when the reserve principle was abandoned, so was an effective political constraint on the size of the old-age insurance program and the ability to transfer the cost of the program onto future generations. Funding was a rule that had defined, in some senses, a range of permissible fiscal outcomes.[1]

The Elimination of the Fund and the Abandonment of Rules: Funding and Pay-As-You-Go Reconsidered

The claim that the introduction, in 1939, of a pay-as-you-go system of financing old-age insurance would affect adversely voting decisions on the size and nature of the program is at odds with several

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paid $1,500 on the first job plus a non-refundable $250 on the second job. As such, there is no true maximum tax payment for workers with more than one job. (Moreover, since the worker's combined earnings exceed the taxable ceiling, the income earned and taxes paid in his second job are not credited toward future benefit eligibility.)

[1]For a discussion of the importance of institutions in determining fiscal outcomes in a democratic setting, see James M. Buchanan, Public Finance in Democratic Process (Chapel Hill: University of North Carolina Press, 1967); and James M. Buchanan and Richard E. Wagner, Democracy in Deficit: The Legacy of Lord Keynes (N.Y.: Academic Press, 1977).

alternative views.[1] In fact, though, both economically and politically, one could have predicted that a pay-as-you-go system would have been characterized ultimately by fiscal irresponsibility.

This argument does not rely on the erroneous conclusion that the Social Security system cannot pay off its accumulated debts, like a private insurance company, unless it is fully-funded; but nor was this an argument for funding the system in 1935. Nor does the argument rely on the adverse effect of a pay-as-you-go system on aggregate savings and capital accumulation, which has been suggested to be a most important reason for funding.[2] Instead, the argument relies on a simple understanding of the differential information requirements and political power among voter coalitions that characterize the two fiscal systems. Even under ideal conditions, the pay-as-you-go system can

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[1]According to one extreme view, resident-voters, who operate in a world absent of fiscal illusion, would make allowances in their private savings behavior to neutralize the impact of switching from one scheme of finance to another. See Robert J. Barro, "Are Government Bonds Net Wealth?" Journal of Political Economy, LXXXII (December, 1974):1095-118; and a similar analysis by Gary Becker, "A Theory of Social Interaction," Journal of Political Economy, LXXXII (December, 1974). Alternatively, Paul Samuelson has been an outspoken proponent of the pay-as-you-go system or intergenerational "compact" because of the supposed "social" gains inherent in such a scheme. See Paul A. Samuelson, "An Exact Consumption-Loan Model of Interest without the Social Contrivance of Money," Journal of Political Economy, LXVI (December, 1958):467-482.

[2]Martin Feldstein singles out the reduction in capital accumulation and therefore future consumption opportunities as "the primary case" for funding. Martin Feldstein, "The Optimal Financing of Social Security," (unpublished paper, Harvard Institute of Economic Research, Discussion Paper No. 388, 1974).

be expected to generate larger budgets than a funded system.[1] The extent to which the funded and pay-as-you-go budgets diverge, is then enhanced by the presence of costly information and differential voter participation rates.

In many ways, a fully-funded program can be thought of as an ideally constrained, non-political means of financing a compulsory federal system of old-age insurance.[2] In its purest form, the fully-funded program would be one in which both the system and each individual covered by the system were fully-funded. That is, the entire system would have assets (revenues invested at the market rate of interest) sufficient to pay off all accruing liabilities, plus each individual would receive in benefits the actuarial equivalent of his tax payments.

In effect, a compulsory old-age insurance program of this type would represent a collective decision on the part of voters to save some minimum proportion of their earnings over their working lives in return

[1]That is, even with a passive bureaucracy and a relatively well informed electorate, and without differential political power of voter coalitions, majority voting can be expected to generate "too large" social insurance budgets. For an elaboration on this system, as well as more detail on the operation of a pay-as-you-go system, see Edgar Browning, "Social Insurance and Intergenerational Transfers," Journal of Law and Economics, XVI (October, 1973):215-237; and "Why the Social Insurance Budget is Too Large in a Democracy," Economic Inquiry, XIII (September, 1975):373-388.

[2]This is not intended to suggest that a fully-funded, federal system of old-age insurance is Pareto Optimal. To the contrary, there is no evidence that private, unregulated savings and insurance institutions would fail and therefore no normative reasons for proposing a federal monopoly of old-age insurance. On the other hand, given a choice among alternative means of financing an existing federal insurance program, one that is simple, predictable, and generates market-like outcomes is certainly desirable.

for a right to the actuarial equivalent of their tax payments upon retirement age. From the system's first year of operation, tax payments would be deposited with the federal government and invested at the market rate of interest. As persons who had paid taxes over some or all of their working lives retired, the accumulating fund would simply be drawn down to make their benefit payments.

Each year, the tax payments would grow by the rate of growth of the wage base, and covered workers would accumulate entitlements to their own tax contributions plus interest. Should those persons alive in any given year prefer to, say, double benefit payments, the tax rate would have to be doubled first, and only those persons who had paid the new higher tax rate during their entire working lives would receive the higher benefit. Notice that this would simply reflect a collective decision to increase the rate of saving, not the rate of return on one's investment. The rate of return for any given generation could not exceed the market rate of interest.

Alternatively, should those persons alive in any given year prefer to abolish the program altogether and, therefore, set the tax rate equal to zero, the accumulated reserve would be just sufficient to pay off all liabilities.

Regardless of the assumptions made about the economy, this pure fund would have the following characteristics:

(1) The rate of return paid on each individual's tax payments would equal the market rate of interest. As such, no one

would be worse off than had he invested these same sums privately.[1]

(2) The program could be terminated at any time without imposing uncompensated losses on anyone. As such, no decisions are made binding on future generations.

(3) Since those revenues not needed for current period benefit payments would be invested at the market rate, the introduction of the system would have no negative impact on capital accumulation in the economy.

(4) The economy could suffer economic recessions and demographic changes without affecting adversely the status of the fund.

(5) The information requirements of voter-taxpayers would be minimal. A collective decision to increase future benefits is at once a collective decision to increase current taxes. Such a change in the program would represent simply a collective decision to "save" more federally, not a decision to alter the distribution of rates of returns.

(6) A fully-funded program would not be characterized by differential political power of voter coalitions since noone

[1]One cannot, of course, ignore the costs imposed on the individual associated with coercing him to adjust to a collectively determined savings rate; but this would be a cost associated with any type of compulsory program. For those who still wished to save more than federally mandated each year, however, the program would be completely neutral in its impact on individual choice. This last statement, though, assumes away the problems associated with the asymmetrical taxation of capital income and earnings under Social Security.

would have entitlement to current period benefit increases for which they had made no contribution.

In essence, the program would be constrained to generate market-like outcomes, with the exception that the collective rate of savings may exceed that which would have arisen voluntarily. As such, this type of program, as envisioned in 1935, would meet the needs of two frequently cited social objectives: coercing the myopic to save over their lifetimes and protecting against the failure of private savings institutions by compelling certain individuals to save some minimum amount in a systematic and safe way.

What cannot be accomplished with this type of program is a transfer of resources between generations (intergenerational transfers). Specifically, the system could not be introduced, begin paying benefits immediately to the currently elderly, and remain funded. On the other hand, no reasonable equity argument could be made for doing so either. If unearned benefits were, in fact, deemed socially desirable at the outset, they would logically be financed by general revenues.

While an effective rule of funding eliminates the possibility of intergenerational income redistribution, it does not constrain intragenerational transfers. If income redistribution within the retired generation were deemed an additional politically desirable goal, the requirement that each individual within a generation be funded could be dropped. In effect, a distribution of rates of return could be introduced, the only necessary constraint on this distribution being that the average rate of return paid to current beneficiaries equal the market rate of interest.[1] In this institutional setting, there need be no presumption that the total budget remain unchanged. Indeed, whether the equilibrium budget is then larger or smaller depends on the particular distribution of rates of return that emerges from the majority voting process. Should most persons fare better than in the market, at the cost of making the minority significantly worse off, the equilibrium budget would be larger.[2]

While this type of redistribution relaxes a constraint on expansion by politicizing the program to some extent, it still cannot be employed to impose costs on future generations. To remain funded, benefit increases must be preceded by tax rate increases. Moreover, it is not unlikely that the choice of a funded program, with the private insurance counterpart, would condition some notions of equity that would limit the extent of intragenerational transfers.

Quite distinct from the funded system just described, a pay-as-you-go system of finance, as conceived in 1939, is one in which there is no reserve accumulation; but instead, it is a simple tax-transfer program in which benefits to the currently retired are paid by taxes imposed on the currently productive generations. Such a system has been

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[1]Specifically, the constraint would be that the market rate of interest equal a weighted average of the rates of return paid under Social Security, where the weights are equal to the proportion of covered workers earning that rate of return.

[2]This certainly assumes that desired savings responds positively to changes in the rate of return on savings. If this is not true, the problem becomes more complex.

described as analogous to a "chain-letter" in which young workers transfer income to the elderly for a non-contractual agreement that, at the time of their retirement, future generations will be willing to similarly transfer resources to them.[1] If we make the usual assumption that individuals have independent utility functions, the pay-as-you-go system of finance will generate too large budgets, where the funded system is taken as a benchmark.[2] This is a direct result of, in effect, politicizing the system.

A conceptual advantage of this type of program is that it can begin immediately paying benefits to the retired. In fact, those persons who are elderly at the time the program is introduced earn gratuitous or unearned benefits. Moreover, all those persons who retire early in the life of the program, before paying taxes over their

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[1]Milton Friedman used the "chain-letter" analogy in Wilbur Cohen and Milton Friedman, Social Security: Universal or Selective? Rational Debate-Seminars, No. 5 (Washington, D.C.: American Enterprise Institute, 1972), p. 24.

[2]For models of intergenerational transfers which explicitly assume independent utility functions, see Samuelson, "An Exact Consumption Loan Model," Journal of Political Economy, LXVI, 467-482; Peter A. Diamond, "National Debt in a Neoclassical Growth Model," American Economic Review, LX (December, 1965):1126-1150; Martin Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," Journal of Political Economy, LXXII (September, 1974):905-925; Buchanan and Wagner, Democracy in Deficit; James M. Buchanan, Public Principles of Public Debt (Homewood, Ill.: Richard D. Irwin, 1958); and Browning, "Why the Social Insurance Budget is Too Large in a Democracy," Economic Inquiry, XIII, 373-388. Even in the case of intergenerational utility dependence of the Barro-Becker type, the particular redistributive features which characterize Social Security are still likely to lead to overexpansion. Were this not the case, the fact that the elderly invest resources in lobbying for costly program expansion sheds considerable doubt on the Barro-Becker hypothesis.

entire working lives, can earn a rate of return on their tax payments well above that available privately and certainly above that which the system can afford later generations. Once the system is underway, the maximum rate of return payable on workers' tax payments is the rate of growth of the wage base.

Who bears the cost of these unearned benefits? In a very real sense, the payment of the initial gratuitous transfers are made possible by imposing uncompensated losses on worker-taxpayers who are alive when the program is terminated.[1] Indeed, should voters decide to terminate the program altogether, any workers who had paid taxes up until that time, the "terminal generation," would be pure losers since there would be no reserve with which to pay these liabilities.

A second conceptual advantage of this sort of program is that the rate of return payable on one's tax payments may exceed that attainable with the fund if the growth rate of the economy exceeds the market rate of interest. It should be evident, however, that to offset both conceptual advantages there exist practical disadvantages. From strictly an economic point of view:

(1) Should the economy suffer either an economic recession, a reduction in the rate of growth of population, or an upward weighting in the age distribution, the rate of return on tax payments may well fall below that attainable privately, or with a funded system. Even without any

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[1] For a similar argument relating to the burden of the public debt, see Buchanan, <u>Public Principles of Public Debt</u>; and Buchanan and Wagner, <u>Democracy in Deficit</u>.

institutional changes, then, the rate of return under a pay-as-you-go system is uncertain.[1]

(2) The reduction in private savings concomitant with the imposition of the tax is not offset by any accumulation and investment in the public sector. Under certain circumstances, then, the introduction of a pay-as-you-go system can be expected to depress capital accumulation.[2]

Even taking account of these economic problems, it is, in fact, the resulting political problems that are important to the growth and redirection of a pay-as-you-go system of social insurance. More specifically,

(1) Once the system is underway, it cannot be terminated without imposing uncompensated losses on those persons who have paid taxes up until that time. As such, current decisions are made binding on future generations.

(2) Just as those persons who are elderly when the system

[1] Note that by nature of a pay-as-you-go system, the growth rate of the economy relative to the market rate of interest is crucial in assessing its desirability. When this is taken into account, doubt is cast on the reasonableness of imputing these calculations to the founders of the pay-as-you-go system in 1939, only six years after the trough of the Great Depression.

[2] This prediction follows directly from the intergenerational models of growth and capital accumulation by Diamond and Felstein. In fact, Feldstein estimated that without Social Security, personal savings would have been more than double the actual amount of $38.2 billion in 1969. Again, however, the issue of whether or not Social Security depresses capital accumulation is inextricably related to the issue of overexpansion. See Feldstein, "Social Security, Induced Retirement, and Aggregate Capital Accumulation," Journal of Political Economy (1974), 905-925.

begins receives gratuitous transfers, so can any generation that is elderly when the tax rate is increased. In effect, the larger is the tax rate imposed this period, the higher is the rate of return for the currently retired. As such, a decision to increase the tax rate represents a collec-iive decision to alter the distribution of rates of return between generations, not just a decision to "save" more.

(3) Since there are no implied minimum rates of return, the introduction of a pay-as-you-go system bestows considerable power to majority coalitions. The only effective constraint on intergenerational transfers are, in fact, the total resources in the economy and the age distribution.

(4) Since benefits payable vary directly with the number of persons subject to the tax, and since tax rates necessary to finance any given level of benefits vary inversely with the number of persons subject to the tax, both current beneficiaries and current taxpayers are motivated to expand program coverage (increase the number of taxpayers) to non-participants.[1]

(5) Because of the susceptibility of rates of return to economic and demographic changes, and because of the lack of

[1] The incentive of covered workers to coerce participation by non-covered workers as well as the incentive to increase the real ceiling on taxable earnings as a means of redistributing costs would not have been characteristic of a fully-funded program.

competing suppliers of viable substitutes, the information requirements for voter-taxpayers are significantly larger than under a funded system. As a result, the role played by the bureaucracy is increased. Similarly, the costs of obtaining information on the impact of program changes are significantly higher for taxpayer groups than for beneficiary groups under a pay-as-you-go system. For both of these reasons, program expansion may be difficult to constrain.

Importantly, then, since the rate of return on one's tax payments under a pay-as-you-go system is politically determined, the abandonment of a funded program in 1939 was the elimination of rules which would have defined a range of tolerable political outcomes and, in effect, protected the rights of the minority. As one's age increases, or as the proportion of elderly persons increases, or as the political power of the elderly in a majority voting context increases, there would result pressure for expansion. Indeed, the rate of return one generation can earn under a pay-as-you-go system is a function of the extent to which taxes can be imposed on another generation. In fact, it is quite possible that a tax rate (or benefit level) might ultimately be established that would be politically infeasible were future generations able to vote, or were it voted upon at the inception of the program.[1]

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[1]However, by the time the tax rate becomes effective, worker-taxpayers would be made even worse off to eliminate the program altogether and assure themselves a rate of return of minus one.

The difficulty of constraining the program expansion associated with the extraction of resources from minority coalitions and non-voting future generations is enhanced should there exist, as well, a distribution of rates of return among current beneficiaries. As embodied in the 1939 Amendments, the rate of return that could be earned is, then, a function of the extent to which taxes can be imposed on not only another generation, but also other persons within one's generation.

It was certainly a recognition of the difficulty of constraining a pay-as-you-go system that generated demands for a funded program in 1935. On the other hand, it was the difficulty of maintaining rules in the face of a $1.7 billion ($6.6 billion) fund in 1939 that led to its abandonment.[1] It was simply not in the interests of Social Security officials, the elderly, near-elderly, survivors, and dependents--the many direct beneficiaries of Social Security--to constrain program expansion and redirection.

In sum, the importance of the 1939 Amendments cannot be overstated as they liberalized and extended the program and redirected it from its initial insurance function. By doing so, and by introducing at the same time misleading insurance terminology, the stage had been set for the growth and liberalization the program has since then experienced. Once the concept of individual equity was dismissed as the

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[1] U.S. Department of Health, Education, and Welfare, Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 61.

driving force of the program, almost any future changes, whether demanded by special interest groups or recommended by supply-side bureaucrats, could be rationalized on the grounds of social justice.[1] When the reserve principle was abandoned, there remained few effective constraints on transferring the cost of the program onto future generations. Finally, the amendments increased manyfold the program's complexity. In 1935, there was only one beneficiary category, the retired worker, and only one set of eligibility criteria. In 1939, there were instituted benefits for elderly wives, elderly widows, widows with children, dependent children, surviving children, and even dependent, surviving parents. Age and eligibility criteria were diverse. Because of the resulting difficulty of assessing true individual costs and benefits, the complex, piece-meal program would become particularly susceptible to political demands for expansion. Indeed, once special benefits were bestowed to particular groups of voters, there would emerge demands for uniformity (expansion) to eliminate the seeming "inequity."[2]

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[1] It seems evident that the private insurance analogy, which accounts for the program's sustained popularity, has created enough confusion over the actual impact of the program that rationalizations for changes based on social adequacy arguments have been integrated into defenses of the system on equity grounds. The program, however, has shown these two goals to be inconsistent.

[2] The program's history has witnessed many times this special privilege-uniformity cycle which tends to perpetuate the program's growth. For example, for special reasons, women workers merited retirement benefits at an early age in 1956. In 1961, the program was expanded to grant earlier benefits to men to correct an "inequity." There are other examples as well.

An Overview of Trends: 1940-1960

Recognizing the large potential gains to direct beneficiaries of the introduction of a complex pay-as-you-go Social Security system, it is somewhat surprising that a "fiscal crisis" was not generally perceived to have arisen until the 1970's. In fact, however, the exploitation of the redistributive potential of the program began nearly two decades prior to that time.

As early as January 1, 1940, greatly expanded in scope and just beginning its first year paying monthly insurance benefits, the Social Security program was already the subject of renewed recommendations.[1] Neither Social Security officials nor key expansionist lobby groups were content with their achievements in 1939. In 1940, predating Congressional action by fifteen to twenty years, both the American Federation of Labor (AFL) and the National Consumers' League called for the expansion of the program to include disability and health insurance, as well as the extension of compulsory coverage.[2]

Echoing the seemingly inexhaustible demands of the bureaucracy, Ellen Woodward, member of the Social Security Board, addressed a conference of social workers in 1943, and said,

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[1] As of 1940, the Social Security Board was no longer an independent agency. The Federal Reorganization Act of 1939 created the Federal Security Agency to administer the Board, the U.S. Public Health Service, the Office of Education, the Civilian Conservation Corps, and the National Youth Administration.

[2] Daniel Sanders, Impact of Reform Movements, p. 101.

> After seven years of experience we all know that the program doesn't go far enough. Our steps toward social security in this country have been sound steps but they have not yet led into all our homes nor all the situations that breed hazards and insecurity . . . . We believe the time has come to extend our present program to fill in the gaps.[1]

In 1945, on the tenth anniversary of the enactment of Social Security, President Truman announced his support for program expansion.[2]

For the most part, however, expansion of the program was effectively blocked in the 1940's by a waning of interest in domestic policy with the onset of World War II. Additionally, a conservative post-war Congress, captured by the Republicans in 1946, was not conducive to the enactment of costly program changes. Aside from a few changes, which included an increase in the federal share in public assistance, the Social Security Act remained intact in its 1939-amended form.

In fact, it was not until the Democrats recaptured the Congress in 1948 that momentum reemerged for program expansion under the Truman Administration.

Coverage Expansion and Program Proliferation

Of the many changes in Social Security to be enacted during the 1950's, perhaps the most notable was the use of coverage expansion to

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[1]Ellen Woodward, "Social Security Today and Tomorrow" (address before the Mississippi Conference of Social Workers, April 29, 1943, unpublished addresses by members of the Social Security Board, Library, U.S. Department of Health, Education, and Welfare), p. 2.

[2]Daniel Sanders, The Impact of Reform Movements, p. 101.

finance rapid increases in expenditures. Between 1949 and 1960 alone, 22 million workers were brought under the OASDI program.[1]

The issue of coverage expansion is of particular interest because at the same time it tended to change the basic nature of the Social Security program by eliminating one of its major objectives--limited coverage--it also had fairly widespread bipartisan support.[2] Indeed, coverage expansion was not only politically appealing to currently covered workers, current beneficiaries, and social insurance advocates, but also was demanded by many uncovered groups of workers. In essence, coverage expansion represented a direct means through which each of these groups could exploit the potential of the pay-as-you-go system.

From the point of view of uncovered workers, particularly lower income and older persons, Social Security provided an unusually attractive "investment" during the 1950's, relative to that which could

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[1]Congressional Quarterly Service, Congressional Quarterly Almanac, VI, 140; and X, 188.

[2]Quite rationally, the most intense opposition to coverage expansion was exerted by self-employed professionals--those least likely to fare well under a redistributive program. Also, some fiscal conservatives still advocated the complete abandonment of the compulsory insurance program as inferior to private voluntary institutions. At the least, however, they recognized the importance of holding the line on the expansion of the program: (1) into other realms of private sector activity like the provisions of disability and health insurance, and (2) to prohibit the federal government from overtaking any more rights in the fields it had already permeated, for example, through real increases in the maximum taxable earnings.

Recall that the three major objectives of the original Social Security Act were: (1) limited coverage; (2) benefits closely related to earnings; and (3) a program financed on a fully-funded basis. U.S. Social Security Board, Annual Report: 1935-1936, p. 14.

have been purchased privately. In its first years in operation as a pay-as-you-go system, persons were retiring with benefit payments well in excess of their actuarial equivalent. In fact, the past Chief Actuary of the Social Security Administration estimated that,

> The proportion of OASDI benefits that has been "actuarially purchased" by those retiring in the early decades of operation has been from less than 1 percent in some instances to at most about 10 percent.[1]

From the point of view of currently covered worker-taxpayers and current beneficiaries, coverage expansion appeared clearly desirable. Because of the nature of a pay-as-you-go system, tax rates necessary to finance any given level of benefits would vary inversely with the number of persons subject to the tax. Similarly, holding the tax rate constant, benefit levels would be varied directly with the number of persons subject to the tax. Indeed, as shown in Table 27, in the face of a twelve-fold increase in real expenditures between 1949 and 1959, coverage expansion made possible an increase in the real maximum individual tax payment of only three-fold. The fact that coverage expansion has

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[1]Robert Myers, <u>Social Security and Allied Government Programs</u>, pp. 140-141. Moreover, a recent empirical study found that the average real rate of return for persons retiring in 1970 exceeded 14 percent. See Alan Freiden, Dean Leimer, and Ronald Hoffman, "OAI Internal Rates of Return: Some Preliminary Results from Individual Earnings Histories," (unpublished paper, Social Security Administration, 1976). For additional cost-benefit studies, see Colin D. Campbell, "Social Insurance in the United States: A Program in Search of an Explanation," <u>Journal of Law and Economics</u>, XII (October, 1969):249-265; and Attiat F. Ott and David G. Ott, <u>Social Security: Problems and Prospects</u>, Domestic Affairs Study (Washington, D.C.: American Enterprise Institute, 1975). Whereas the first study examines the significant negative correlation between earnings and rates of return for beneficiaries within a given generation, the latter two studies examine the prospects for significantly reduced rates of return over time.

TABLE 27

FINANCING SOCIAL SECURITY
1937-1959

Year Act amended	Years effective	Maximum taxable earnings	Combined tax rate OASI	Combined tax rate DI	Max. indiv. tax payment (1975 dollars)
1935	1937	$3,000	2%		$224
	1938	3,000	2%		229
	1939	3,000	2%		223
	1940	3,000	2%		229
	1941	3,000	2%		217
	1942	3,000	2%		198
	1943	3,000	2%		186
	1944	3,000	2%		183
	1945	3,000	2%		179
	1946	3,000	2%		165
	1947	3,000	2%		144
	1948	3,000	2%		138
	1949	3,000	2%		133
1947	1950	3,000	2%		133
1950	1951	3,600	3%		223
	1952	3,600	3%		219
	1953	3,600	3%		217
	1954	3,600	4%		288
1954	1955	4,200	4%		337
	1956	4,200	4%		332
1956	1957	4,200	4%	.5%	361
	1958	4,800	4%	.5%	402
1958	1959	4,800	4.5%	.5%	442

SOURCE: Department of Health, Education, and Welfare; Social Security Administration, History of the Provisions of OASDHI: 1935-1973 (Washington, D.C.: Government Printing Office, 1974), p. 7.

generated windfall gains to the near-elderly and current beneficiaries is certainly important in explaining the persistence of lobby group demands for expansion.[1]

Finally, from the point of view of Social Security officials and other social insurance advocates, coverage expansion represented an important and, at that time, noncontroversial means of reducing competition. The existence of large groups of uncovered persons, particularly higher income workers, who relied on private, voluntary savings institutions not only permitted the growth of alternative and competing sources of supply, but also limited the possible range of redistributive outcomes.[2] This concern was aptly conveyed by Edwin Witte in 1950, only months before major coverage expansion was enacted, when he said,

> At this time we appear to be at a crossroads as regards social security. Growth of social assistance, the spread of private pension plans, and the rapid development of forms of public medical care, doom social insurance in this country unless it is soon made more extensive.[3]

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[1]The incentive of persons currently under the system to coerce non-participants would not have been characteristic of a fully-funded program.

[2]In 1955, average annual earnings in covered employment were $2,881, or 31 percent lower than average annual earnings in all employment--$4,128. See Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 66; and U.S. Department of Commerce, Statistical History of the U.S., p. 164.

[3]Edwin E. Witte, "Social Security and Free Enterprise," an address at the Kansas State Teachers' College, April 13, 1950 (unpublished addresses, Library, U.S. Department of Health, Education, and Welfare), p. 8.

On what grounds did the Social Security Board and early advisory councils defend universal, compulsory coverage? "Ten years experience with incomplete coverage has revealed the many inequities and anomalies which arise" when workers move between covered and uncovered employment.[1] Since the system had been designed so that it benefitted persons with shorter periods of covered employment (by weighting the benefit formula toward lower average earnings) these same persons were very costly to provide benefits for. Thus, the need for universal coverage was based not on earlier public goods arguments that uncovered groups ought to be compelled to help prevent destitution in their old-age, but was based implicitly on the anomaly that the operation of the government program itself created externalities--costs were imposed on all covered workers to provide relatively expensive benefits to persons who moved between covered and uncovered jobs so as to qualify for benefits with the minimum eligibility--which by expanding, it could internalize.[2] Indeed, rather than question the advisability of the true source of the

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[1]U.S. Advisory Council on Social Security, Final Report of the Advisory Council on Social Security: 1948 (Washington, D.C.: Federal Security Administration, 1948), p. 6.

[2]A more sophisticated argument might be that the reduction in poverty, associated with the introduction of a redistributive social insurance program, and the concomitant reduction in general revenue expenditures is a public good for which all workers ought to contribute. On the other hand, this argument would make very clear the redistributive nature of the program.

In either case, it is unquestionably true that "bureaucrats see in the failure of their preceding measures a proof that further inroads into the market system are necessary." Ludwig von Mises, Bureaucracy (New Rochelle: Arlington House, 1939), p. 31.

"anomaly," the benefit formula, Social Security officials were content to discredit those persons who were able to profit from its construction. Historically, this has proved to be an effective means of generating demands by covered workers for compulsory coverage of other groups. As shown in Table 28, by 1960, the program had expanded to the point that nearly 90 percent of all workers were covered by Social Security.

In sum, coverage expansion was a noncontroversial way of generating billions of dollars worth of additional revenues. Rather than being invested, as would have been the case with a funded program, these revenues were translated into benefit increases for current beneficiaries and gratuitous transfers to new beneficiary groups. Moreover, rather than take advantage of the individual tax reductions made possible by an expansion of coverage, Congress legislated changes that would generate more and larger benefit claims in the future. In effect, the appearance of a "fiscal crisis" was postponed.

The Truman Years: "Cradle-to-Grave" Social Insurance Advocated

The Amendments of 1950: Expansion and Liberalization

The amendments of 1950 contributed to the first extensive coverage expansion, and marked the culmination of five years of Congressional study and support by Social Security officials. The amendments, signed into law by President Truman on August 28, 1950, extended compulsory

TABLE 28

OASDI COVERAGE (1937-1959)

Date enacted	Employment covered: Compulsory	Employment covered: Elective by employer	Employment covered: Elective by employee and employer	% in cov. emp.
1935	All workers in commerce and industry (except railroads) under age 65 in continental United States, Alaska and Hawaii, and on American vessels.			
1939	Age restriction eliminated			
1950	Regularly employed farm and domestic workers. Nonfarm self-employed (except professional groups). Federal civilian employees not under retirement system. Americans employed outside United States by American employer. Puerto Rico and Virgin Islands	State and local government employees not under retirement system.	Employees (other than ministers) of nonprofit organizations (employees voting against coverage are not covered, new employees are covered).	64.5%
1951	Railroad workers with less than 10 years of service, for all benefits.			79.5

TABLE 28--Continued

Date enacted	Employment Covered: Compulsory	Elective by employer	Elective by employee and employer	% in cov. emp.
1954[a]	Farm self-employed. Professional self-employed except lawyers, dentists, doctors, and other medical groups. Additional regularly employed farm and domestic workers. Homeworkers.	Americans employed outside United States by foreign subsidiary of American employer.	State and local government employees (except firemen and policemen) under retirement system.	79.3%
1956	Members of the uniformed services. Remainder of professional self-employed except doctors. Farm landlords who materially participate in farm operations.		Firemen and policemen in designated States. State and local government employees under retirement system in designated States may be divided into two systems, one excluding employees not desiring coverage (new employees covered).	86.7%

SOURCE: Department of Health, Education, and Welfare; Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), p. 15.

[1] In 1954, coverage was extended to ministers on an "elective by individual" basis.

coverage to an additional 10 million workers and increased benefit levels 70-100 percent.[1]

As has been the case historically, issues of debate and policy proposals were diverse. Policy proposals ranged from a rejection, by conservatives, of the insurance features of the program in favor of more extensive means-tested relief, to the acceptance by liberals of the extension of the program to include "cradle-to-grave" protection.

Advocates of cradle-to-grave insurance had been unsuccessful in amending the program earlier because of popular conservative sentiments in the late 1940's. These sentiments were of concern to social insurance advocates even up until the time the 1950 Amendments were enacted. In 1950, just before enactment, Edwin Witte, former Executive Director of the CES, remarked that during the past two years, a "great outcry has been raised that the quest for social security is undermining our economy of free enterprise and threatens freedom itself."[2] This complaint, he said, had never been more strongly advanced.

Rather than expand the program, the predominately Republican Congress had actually reduced slightly the program's coverage in 1948.[3] In that same year, Truman raised this action as a major political issue

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[1]For a general discussion of the amendments and the debates surrounding their enactment, see Daniel Sanders, Impact of Reform Movements, pp. 103-107. Also, see Congressional Quarterly Almanac, V, 288-292, and VI, 165-177.

[2]Edwin Witte, "Social Security and Free Enterprise," p. 1.

[3]Newspaper and magazine vendors were excluded from coverage and a narrower definition of "employee" was introduced. See Daniel Sanders, Impact of Reform Movements, p. 103.

and endorsed national health insurance. By the fall of 1948, the Democrats had regained control of the Congress.

The appointment of the Advisory Council on Social Security by Senate resolution in 1947 confronted expansionists with more concern as some felt that employer interests, or the Chamber of Commerce influence, were too strongly represented.[1] Two employee representatives, Mr. Cruikshank and Mr. Rieve, of the AFL and the CIO, had considered resigning their membership upon seeing the list of other members.[2] Six of the seventeen appointed members were, in fact, from private industry, but representing varying degrees of "employers' interests." As had been the case in 1938, Mr. Folsom, who later became the Secretary of Health, Education, and Welfare (HEW), was on the committee representing employers. In addition, the "Citizens Advisory Committee" included Douglas Brown, a consultant to the Social Security Board and 1938 advisory council member, as well as Frank Bane, former Executive Director of the Social Security Board.

Despite concern, the Report of the 1948 Advisory Council advocated most of the revisions endorsed by the Social Security Board. They recommended liberalizing the determination of insurance and

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[1]For a list of members, see U.S. Advisory Council on Social Security, Final Report: 1948.

[2]Wilbur Cohen, a Social Security Board staff member, purportedly wrote Mr. Cruikshank a reassuring letter that Social Security Board Chairman Altmeyer and other staff members would address the Council during its opening meeting since, he said, experience had indicated that it took several meetings "to bring all the members around to the same level of knowledge about the program and suggestions for change." Marjorie Shearon, Wilbur Cohen, pp. 139-141.

benefit eligibility status, liberalizing benefit formulas, increasing benefits, postponing scheduled tax rate increases, and raising the taxable ceiling. Nearly all of the recommendations made by the Advisory Council and endorsed by the Social Security Board were enacted at some time during the 1950's.[1]

Early in 1949, comprehensive hearings began in the House Ways and Means Committee for the purpose of studying the Administration's recommendations. These recommendations, supported by "cradle-to-grave" social insurance advocates and explained by Social Security officials, included: extended coverage, benefit increases of up to 100 percent, a significantly liberalized OASI program, as well as the inclusion of disability insurance.[2] Among the various persons who appeared at the hearings, Altmeyer and Brown advocated extension of social insurance as preferable to, and capable of supplanting, relief; and among the conservatives, ex-President Hoover called for the expansion of

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[1]In particular, the 1948 Advisory Council recommended extending coverage to farm workers (enacted in 1950), household workers (1950), and employees of non-profit organizations excluding churches (1950-on an elective basis), federal civil service (1950-for those employees not covered by the federal plan), armed forces (1956), state and local governments (1954-on an elective basis). The advisory council added that voluntary coverage was only "defensible" if the federal government was unable constitutionally to compel certain groups of workers to pay taxes, i.e., state and local governments. See U.S. Advisory Council on Social Security, <u>Final Report: 1948</u>, p. 8, and U.S. Department of Health, Education, and Welfare, <u>History of the Provisions of OASDHI: 1935-1973</u>, p. 1.

[2]Since the time benefits were first payable in 1940, prices had risen more than 70 percent.

means-tested relief rather than an increase in OASI benefits.[1] If Social Security were, indeed, grounded on insurance principles, it could not eliminate entirely the need for a poverty relief program.

On August 22, 1949, the House Ways and Means Committee reported a clean bill (HR 6000) which called for extensive revision of the Act, yet it was moderate in contrast to the Administration's proposals.[2] The committee reduced projected coverage expansion by 11 million persons from the 20 million recommended by the Administration, and maintained rather than liberalized benefit computation periods and eligibility requirements. Also, the committee recommended significantly higher tax rates and a lower taxable ceiling than did the Administration.[3] Finally, the committee accepted the Administration's proposals to extend retirement benefits to the permanently and totally disabled, and to increase the federal government's share in public assistance

[1] Congressional Quarterly Almanac, V. 288.

[2] Ibid., V, 288-292, and VI, 165-177. See also Lewis Meriam, Karl T. Schlotterbeck and Mildred Maroney, The Cost of Financing Social Security (Washington, D.C.: The Brookings Institute, 1950).

[3] Keep in mind that the Administration's proposals would have not only expanded significantly the scope of the program, but also enhanced its redistributive impact. Increased expenditures financed by maximum taxable earnings hikes (rather than tax rate increases) impose no additional costs on covered workers below the taxable ceiling. Instead, the full cost of additional expenditures, which are distributed more heavily toward the poor, is shifted to the 20-30 percent of workers who earn more than the previously existing taxable ceiling. As such, ceiling hikes, endorsed by liberal congressmen, the AFL-CIO, and other redistributionists, transfer the burden of increased expenditures onto those persons who could have best employed private savings institutions, and generate windfall gains to current beneficiaries and the near-elderly, particularly those with low earnings. For more on this, see infra, pp. 407-411.

grants; but it eliminated the Administration's proposal to extend public assistance to the temporarily disabled (including maternity benefits).

A minority report was issued by ten Republicans, including seven Republicans who had voted with the majority, that reflected aptly the conservative attitude. They agreed that the program's coverage ought to be extended, as this was being demanded by many uncovered groups, but they expressed the belief that the bill was

> . . . inconsistent with the fundamental purposes of compulsory social insurance . . . to provide a basic floor of economic protection for the individual and his family and in so doing to encourage and stimulate voluntary savings through personal initiative and ambition. It should not invade the field historically belonging to the individual.[1]

Similarly, increased federal matching under the public assistance titles, they thought, would transfer too much responsibility to the federal government.

The committee bill was shortly thereafter passed in the House without amendment. As has been the case historically, the bill had been considered under the "closed rule" which prohibited amendment from the floor or from dissenting members of the committee.

The bill which emerged from the Senate Finance Committee was different from the House bill in some important respects. Most notably, the OASI program and its coverage were vastly liberalized, while the provisions for disability insurance had been eliminated.

Lobby stands were as follows. The CIO and AFL endorsed the Administration's bill and called for extensive coverage, a much larger

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[1] Congressional Quarterly Almanac, V, 289.

taxable ceiling, sickness, disability and health insurance, and government contributions. The CIO recommended increasing tax rates on employers, as well. Lobbyists opposed to expansionism included the Chamber of Commerce, the National Association of Manufacturers (NAM), and the Committee for Constitutional Government. Concerning the cost of the proposed program, the NAM said, "The present generation of Americans is attempting to secure its future by issuing promissory notes which will have to be made good by our children and grandchildren."[1] The Committee for Constitutional Government recommended compulsory purchase of private insurance, as social insurance, they said, was created to prevent the "thriftless from sponging on the thrifty."[2]

As enacted in August, the 1950 amendments included thirty major changes in the Social Security Act, yet did not encompass some of the comprehensive revisions advocated by the President, Social Security officials, and the advisory council. Compulsory coverage was extended to the self-employed (except doctors), agricultural workers, domestic servants, federal employees not covered by the federal retirement system, and persons in the Virgin Islands and Puerto Rico--nearly 8 million persons; and voluntary coverage was extended to 2-1/2 million

[1] Ibid., p. 291.

[2] Op. cit. If Social Security were, in fact, designed simply as an instrument for compelling individuals to save over their working lives, there would exist no normative reasons for mandating that this compulsory savings be done through a federal agent. James M. Buchanan has explored the proposal to permit compulsory savings with either public or private firms in "Social Insurance in a Growing Economy: A Proposal for Radical Reform," National Tax Journal, XXI (December, 1968):386-295.

employees of non-profit organizations, and state and local government employees not covered by their own system. Benefit formulas and eligibility requirements were liberalized.[1] Benefit payments were increased 77.5 percent for current recipients, constituting little more than a cost-of-living increase. To partially finance additional expenditures, the taxable ceiling was increased to $3,600 ($8,035) and future tax rates were increased.[2]

Concerning the public assistance titles of the Social Security Act, the federal share was increased again, and a new type of categorical assistance was introduced: Aid to the Totally and Permanently Disabled (ATPD). This emerged as a compromise measure, as both in the Senate and in conference, the Administration's proposal for disability insurance had been rejected.

The net impact of the program changes was a significant increase in the scope of the program, and its current and future costs. Continued liberalization of benefits and the benefit formula enhanced the redistributive impact of the program, again, weighting the returns

[1]Note that when benefit coverage is expanded or benefit eligibility requirements are reduced, thousands of persons automatically become eligible to draw benefits, or to draw higher benefits, without paying any additional taxes.

[2]Federal Security Administration, Annual Report: 1951 (Washington, D.C.: The Federal Security Administration, 1952), and Congressional Quarterly Almanac, VI, 166. The benefit increase exceeded the rate of inflation by 1.5 percent. The taxable ceiling, however, was not raised from its 1937 level in real terms until 1967. From that time onward, fairly large real increases were legislated.

The 1950 Amendments also marked the formal endorsement of entirely payroll tax-supported insurance programs. The authority for government contributions, contained in the 1935 Act, was deleted.

toward persons with low average earnings, and non-single annuitants. In effect, the array of changes moved the program further from the concept of individual equity. Real increases in the minimum benefit payable and a more heavily weighted benefit formula made it clear that many maintenance-relief functions were being taken over by the program.

The rapid expansion of coverage made prospects for the program's longevity and growth more certain. There had been some concern among advocates that the long delay, since 1939, in the extension of federal power made the program's future less certain; for the growth of alternative and competing sources of supply, both private and public (at the local level), might certainly have limited the scope of future social security expansion. These fears were not borne out in the enactment of the 1950 Amendments. By 1951, recipients of old-age insurance benefits exceeded the number of old-age assistance recipients for the first time in history, largely because of liberalized eligibility for old-age insurance benefits.[1] In fact, nearly 100,000 recipients of old-age assistance became eligible for OASI benefits immediately upon

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[1]Annual Report of the Federal Security Administration: 1951, p. 23. Whereas the number of elderly persons receiving Old-Age Assistance had doubled from 1.1 million to 2.8 million between 1936-1950, the continued liberalization of eligibility requirements and the increase in minimum benefits payable under the OASI program had led to a steady decline in the absolute number of Old-Age Assistance recipients since 1950, Social Security Administration. Social Security Bulletin: Annual Statistical Supplement, 1973, p. 157.

the enactment of the 1950 Amendments.[1] Rather than supplementing in the long-run means-tested relief for the elderly with old-age insurance, as contemplated in 1935, by coercing persons to save over their working lives, the old-age insurance program was simply overtaking more functions of traditional welfare programs.

Just after the 1950 amendments were enacted, the Federal Security Administration (FSA) issued an annual report praising the newly passed amendments and already advocated additional expansion of the program.[2] In their opinion, "So long as there remain large groups and major economic risks which are not covered, the program falls short of fulfilling its purpose."[3] Despite the fact that this conflicted with the intent of the 1935 Act, as interpreted by earlier Social Security Board reports, they went on to recommend:[4]

(1) Complete coverage of all gainful workers.

(2) Provision of insurance benefits for sickness, disability, and medical care.

(3) Public assistance for all "residual needs."

In their 1951 annual report, the FSA reiterated their demands for expanding the scope of social security. The lack of medical and

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[1]Ibid., p. 4.

[2]The Federal Reorganization Plan of 1946 abolished the Social Security Board within the FSA. Arthur Altmeyer, former Chairman of the Social Security Board, became the Commissioner of Social Security. Marjorie Shearon, Wilbur Cohen, p. 154.

[3]Annual Report of the Federal Security Administration: 1950, p. 15.

[4]Ibid., p. 16.

disability insurance was termed a "major deficiency" in the existing program.[1] Once a means-tested assistance program for the disabled had been created, however, it would only be a matter of time until there would arise demands for disability insurance in order to reduce burdensome state welfare costs. In fact, the first headway toward the creation of disability insurance was made only two years later.

The Amendments of 1952: The First Real Benefit Increase

The speed with which the 1952 Amendments to the Social Security Act were enacted was unprecedented. The 1952 amendments were introduced into Congress May 12, 1952, and passed only two months later. Coverage was not extended, but benefits were increased by 12.5 percent in order to keep "pace with the rate of inflation." Federal grants to the states for public assistance were also increased.[2]

During the hearings, the most controversy was generated over the issue of disability benefits. An amendment had been offered to permit a "disability freeze," that is, to allow covered individuals to maintain their accrued insurance rights, without paying taxes during

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[1] Annual Report of the Federal Security Administration: 1951, pp. 11-13.

[2] For a discussion of Congressional legislation and debates surrounding the enactment of the 1952 amendments, see Congressional Quarterly Almanac, VIII, 140-142.

While the rate of inflation is most often the key rationalization for benefit increases, as most frequently has been the case, benefit increases outpaced the rate of inflation by 3 percent. In cases that this has not been true, previous benefit increases have typically more than offset price increases forthcoming (See Table 32).

periods of disability. The FSA would have been authorized to examine and determine disability. The American Medical Association (AMA), backed by conservatives, ardently opposed the disability provision on the grounds that it would lead ultimately to socialized medicine.[1]

Congress responded to the controversy in an unusual manner by putting disability benefit provisions in the amended Act, but in such a manner that no one could have qualified. The 1952 amendments, as enacted, prohibited disabled persons from applying for benefits under this provision until July 1, 1953; but the provision was not to remain effective after June 30, 1953.[2]

The speed with which the 1952 amendments were enacted is attributable to several important factors.[3] First, President Truman had already addressed Congress in 1952 endorsing strongly the expansion and liberalization of the program. While the 1950 amendments had made headway, some significant changes which he and the Social Security official had endorsed had not been acted upon. Second, there were no major bills before the Ways and Means Committee, and extensive hearings on Social Security had already been held prior to 1950. Third, Representative R. L. Doughton, the Chairman of the Ways and Means Committee, who sponsored the original Social Security bill in 1935, and sponsored

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[1] Congressional Quarterly Almanac, VIII, 142.

[2] Daniel Sanders, The Impact of Reform Movements, pp. 108-109. This may have been done simply to get the "concept" of disability benefits passed along with more popular Social Security benefit increases. At a later date, disability benefit provisions could be included by a simple "technical correction."

[3] Daniel Sanders, The Impact of Reform Movements, pp. 107-109.

the pending bill, was due for retirement at the end of the session. It was deemed appropriate by some Congressmen, therefore, to enact some final legislation with his name. On a more practical note, 1950 was an election year and benefit increases were popular when not accompanied by tax increases. This latter fact accounting for quick action in 1952 was destined to become of major importance as the 1950's were to witness a decade of biennial, election year benefit increases or benefit liberalizations.[1]

The Eisenhower Years: The Drive for Universal Coverage

Although 1953 ushered in the first Republican president in twenty years, the Eisenhower years attested to the strength of social insurance expansionists. Many changes instituted during these years led to an extension and expansion of the program that had been actively opposed by both the President and the Secretary of HEW.[2] The momentum gained by active lobby groups, advisory councils, Social Security officials, and a Democratic Congress was only slightly curtailed by the threat of Presidential veto. Amendments were enacted in 1954, 1956, and 1958 which increased and liberalized benefits, extended

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[1]By the 1960's and early 1970's, the rapidly increasing number of beneficiaries to the complex OASDHI program had become powerful politically--program expansions, if not benefit increases, were enacted almost annually.

[2]The Department of Health, Education and Welfare was created in 1953. Secretaries during the Eisenhower Administration included Ovetta Culp Hobby, Marion Folsom, and Arthur Flemming.

coverage, and increased tax rates and the taxable ceiling. Additionally, benefits were extended to the disabled at age fifty (1956), and the retirement age for women was reduced to sixty-two (1956).[1] Regarding public assistance to the aged needy, a nonuniform grant program was introduced to aid lower income states (1958). The enactment of the 1958 amendments would mark the fifth liberalization of the Social Security program in as many election years.

The Amendments of 1954: Expansionism--A Bipartisan Issue?

It has been said that the 1954 amendments, although not significantly affecting the scope of the program, were important in marking the entry of Social Security as a bipartisan political issue.[2] This tells, however, only part of the story. While Eisenhower and Congressional conservatives supported expansion of coverage, and an increase in the role of social insurance relative to social welfare, they repeatedly opposed proposals that would have led to a marked increase in future costs, thus threatening the actuarial soundness of the system, as well as proposals that might have threatened states' rights. Hearings on proposed amendments to the Act, particularly in 1954, attested to the fact that social insurance expansionism was not yet a bipartisan issue.

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[1] U.S. Department of Health, Education, and Welfare, Social Security Administration, History of the Provision of OASDHI: 1935-1973 (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1974).

[2] Daniel Sanders, The Impact of Reform Movements, p. 123.

In his State of the Union address, February 2, 1953, President Eisenhower called for extended coverage, and later endorsed putting the system more nearly on a pay-as-you-go basis.[1] Although the intention of building up a fund had been eliminated in 1939, reserves had not yet been fully depleted.

Shortly thereafter, the House Ways and Means Committee set up a special subcommittee to investigate thoroughly the many issues of Social Security. Already, 200 bills had been introduced in the first session of the 83rd Congress. The subcommittee, chaired by Representative Carl Curtis (R.-Neb.) began hearings in July, and appointed a special research staff to report the following year.[2] No action was taken during 1953 on the President's proposals, but heated debates ensued. In fact, it was during the 1953-1954 legislative session that the Social Security program and its administration faced their first serious public attack since 1936.

An important outgrowth of the 1953-1954 hearings was a study of the Social Security program by a research staff of the House

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[1] Congressional Quarterly Almanac, IX, 199-200. Since the intention to build up a reserve fund had been abandoned 15 years earlier, an attempt to put the system more nearly on a pay-as-you-go basis, as advocated by Congressional conservatives, had the advantage of making more apparent the true cost of the program. Indeed, additional expenditures financed partially by coverage expansion, tax rate increases, taxable ceiling increases, and reserve depletions made an evaluation of the cost burden very difficult.

[2] Ibid., p. 199.

Subcommittee on Social Security entitled, Social Security After 18 Years.[1] The driving force behind the document was a widespread misunderstanding of the program, as evidenced by statements made during the hearings, particularly with respect to the basic principles of the program. Most striking, was the confusion over who was eligible for old-age assistance, and what type of "contract" the worker had under Social Security. It was revealed that many persons did not know that they were not entitled to old-age assistance simply as a matter of right at the age of sixty-five, regardless of need. Further, many people believed they had "contractual rights" to future insurance benefits.

The staff devoted a good deal of attention to the confusion over "rights" in the Social Security program. Specifically, they made it clear that there were no contractual rights, as had been indicated by Social Security officials and believed by many. The only rights were statutory; and by nature, statutory rights may be rescinded at the will of Congress. They went on to give examples of erroneous and misleading statements emitted by officials, as well as examples in which benefit claims had either been reduced in value or totally eliminated.

The report pointed to Social Security officials and their publications as the source of confusion with respect to both the public assistance and insurance titles of the Act. Moreover, Representative

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[1] U.S. Congress, House Ways and Means Committee, Subcommittee on Social Security, Staff, Social Security After 18 Years, A Staff Report to Honorable Carl T. Curtis, Chairman of the Subcommittee, 83rd Cong., 2nd Sess. (1954).

Curtis, who chaired the subcommittee, said that wage earners had been "misled" for the past eighteen years into believing that they had contractual rights to earned benefits.[1] His remarks led Arthur Altmeyer, recently resigned Commissioner of Social Security, to admit that there were, in fact, no contractual rights, but that future benefits were protected by the "full faith and credit" of the government.[2]

Attempts by the subcommittee to make very clear the nature of the Social Security program in operation led to bitter attacks by liberal members of the Ways and Means Committee. In Representative Eberharter's (D.-Pa.) words, the studies were "nothing but an attempt to discredit and smash the present social security system."[3] Later, Altmeyer told Robert Winn, Subcommittee Counsel, that he ". . . was doing more to destroy the confidence of the American people in this system than anybody else--except the Chairman of this committee."[4] Social Security officials certainly recognized that the sustained popularity of the insurance titles of the Act relied heavily on voters' perceptions of the program; most notably, the perception that it was grounded on private insurance principles.

Shortly after the President's State of the Union address in 1954, Chairman Reed submitted a bill (HR 7199) which incorporated the President's recommendation to increase coverage and benefits so as to

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[1] Congressional Quarterly Almanac, IX, 200.

[2] Ibid. Arthur Altmeyer resigned from the Social Security Administration in 1953 after having maintained the highest ranking appointed office since 1936.

[3] Ibid.

[4] Ibid.

reduce the role for public assistance.[1] Regarding public assistance, on January 21, the President recommended instituting a permanent public assistance formula as a means of protecting states' rights and reducing Congressional discretion in continually increasing the federal government's share. To make their feelings on this proposal clear, all the Democratic Senators sponsored a bill, in May, to extend the existing public assistance formula for another two years.[2]

Hearings on the Administration's bill commenced in the House during April, and in the Senate during June. As the bill made its way through Congress, hearings witnessed not only a divergence in attitudes between conservatives and liberals, but also divergence within lobby groups.[3] The Chamber of Commerce called for universal coverage, while the NAM opposed any major action in 1954. The National Grange and National Farmers Union lobbied for extending coverage to farmers; the American Farm Bureau Federation opposed extension of coverage, and the National Milk Producers Federation endorsed voluntary coverage. As usual, labor formed not only a strong but also a unified coalition. They opposed the Chamber of Commerce proposals for a universal pay-as-you-go system, and favored the introduction of disability insurance and a significant increase in the taxable ceiling (from \$3,600 to \$6,000).

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[1]The Administration's proposals are described in more detail in the Congressional Quarterly Almanac, X, 189-190.

[2]Ibid.

[3]For a discussion of lobby stands, see Ibid., 190-194.

The House and Senate bills were not significantly different from one another. As finally enacted, September 1, 1954, the amendments extended coverage to nearly ten million additional workers, especially farm operators and farm workers. Also, voluntary coverage was extended to employees of state and local governments. In all, the amendments resulted in nine out of ten workers being in jobs covered by Social Security. The retirement test was liberalized, a disability freeze provision was introduced, and real benefit levels were increased an additional 12.5 percent. To finance the changes, the taxable ceiling was increased to $4,200 ($8,416) and future tax rates were increased.[1] In accordance with the demands of Senate liberals, the formula for federal grants to states for public assistance was extended for another two years.[2]

The Amendments of 1956: The Introduction of Disability Insurance

The amendments that followed in 1956, signed again only months before the election, attested to the strength of expansionists and the success of the Democratic party in carrying out those demands.[3] The major issue of debate, and eventual successes, concerned the introduction

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[1]Taxes were to be increased from 4 percent in 1954 to a maximum of 8 percent in 1975.

[2]Ibid., 188-189.

[3]For details of the debates and congressional action on the 1956 amendments, see Congressional Quarterly Almanac, XII, 392-397.

of disability insurance and a reduction of the retirement age for women, both of which were opposed by the Administration. In his 1955 State of the Union address, President Eisenhower had made recommendations regarding public assistance only, since the 1954 amendments had already made significant revisions in the insurance titles.

Congress took no action on the President's requests and during 1956, the House passed a bill (HR 7225) to liberalize significantly the Social Security program. The bill included extended coverage, disability insurance, and full benefits to women at age 62.

Lobbyists aligned on issues as would have been expected. Disability insurance was strongly endorsed by the AFL-CIO, Americans for Democratic Action, the United Auto Workers, and the National Consumers League. The AMA and the Chamber of Commerce opposed disability insurance. The AMA argued that not only was disability difficult to determine, but also disability insurance would discourage rehabilitation and would not be conducive to accurate cost estimation. In fact, a study by the Brookings Institute on the Administration's proposal reported that "no country that had ever installed such a system [disability insurance] accurately predicted in advance anything approaching actual cost."[1]

On the issue of reducing the retirement age for women, insurance companies testified that not only was the life expectancy for women

[1]The study finished by concluding that "government agencies which promote its adoption may be suspected of understating costs in their eagerness to get laws on the books," Meriam, Schlotterbeck, and Maroney, The Cost and Financing of Social Security, p. 19.

increasing but also the average retirement age was increasing. As such, it seemed counter to intuition to institute a very costly amendment that would encourage early retirement at a time when the country wanted to encourage employment. Also, it was feared that earlier voluntary retirement might lead to a reduction in compulsory retirement ages in industry.

Disability insurance and early retirement were both opposed by the Administration. In the words of Marion Folsom, the Secretary of HEW,

> The proposals to lower the retirement age for women to 62 would tend to reduce job opportunities for many older workers at a time when our objective is to increase employment prospects for those who desire to work and need employment.[1]

On the issue of disability insurance, he continued

> There is a great deal of divergence of opinion on the difficulties of administering a cash disability program, our ability to control costs, and the effects on vocational rehabilitation . . . We need more time.[2]

Both the President and the Secretary of HEW questioned the advisability of, and warned against, amending the Act in such a way that would increase future costs and, in Folsom's words, "raise serious uncertainties for the future."

As passed by Congress, the 1956 amendments modified only somewhat the bill as passed by the Ways and Means Committee.[3] As enacted,

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[1] Congressional Quarterly Almanac, XII, 395.

[2] Ibid.

[3] Ibid., pp. 392-393.

OASI benefits were payable to fully insured, totally and permanently disabled workers at the age of 50, the benefits for which would be financed by a 1/2 percent increase in scheduled tax rates to be diverted into a special trust fund. OASI benefits were payable to all women at 62; however, women other than widowed survivors were to be subject to reduced benefits. Coverage was extended to self-employed professionals, excluding physicians. Regarding public assistance, the federal share was again increased.

After signing the bill into law (PL 880) on August 1, 1952, President Eisenhower remarked that it had been modified to meet some of his objections but, regarding disability insurance, he said ". . . we are loading on the social security system something I don't think should be there, and if it is going to be handled, should be handled another way."[1]

The 1954 amendments were significant in two important respects. First, as an indication of how powerful a political issue Social Security had become, the amendments were passed against repeated opposition by the Administration. Second, the program had been transformed onto an even more piecemeal basis. By reducing the age of eligibility for certain types of benefits to certain types of recipients, the floodgates were opened to increasing political demands for uniformity to "remove the inequities." More specifically, there would arise pressures to expand the program to provide these same types of benefits to

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[1]Ibid., 397.

currently non-eligible persons, and to reduce the eligibility requirements for other types of benefits.

The Amendments of 1958: Social Security--An Election Year Issue

In 1958, amendments were enacted which liberalized the Social Security program during the fifth consecutive election year. It was said that revisions could not wait until the Advisory Council on Social Security Financing (established by the 1956 amendments) reported in 1959 because of an on-going recession. A report by the Trustees of the old-age and survivors trust fund had revealed that for the first time in history the trust funds were paying out more in benefits than they were receiving in tax receipts.[1]

In 1958, President Eisenhower made no recommendations for expanding Social Security. He did, however, suggest a reduction in the federal government's role in providing relief. Hearings began on amending the Social Security Act in the House during June and in the Senate during August. Considerable attention was given to the public assistance titles of the Act and, indeed, whether an increase in federal grants might lead to Presidential veto.[2]

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[1]U.S. Advisory Council on Financing, Financing OASDI (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1959). This was possible since the system had not yet been fully wound down to a pay-as-you-go system.

[2]For the details of Congressional action and debates on the 1958 Amendments, see Congressional Quarterly Almanac, XIV, 156-159.

As reported by the House Ways and Means Committee, HR 13549 provided for a larger federal role in public assistance as both the rate of matching and the total amount matched by the federal government were to be increased. The newly appointed Secretary of HEW, Arthur Flemming, made it clear as he testified before the Senate Finance Committee that the Administration would support a cost-of-living increase in Social Security benefits, but "strongly opposed" the House committee bill increasing federal public assistance payments. The Administration opposed the public assistance features enough, he said, that he would recommend a veto of the bill unless modifications were made.[1]

By the time the amendments were signed into law (PL 840) August 28, 1958, the 1958 Amendments had been moderated by the Senate and in conference. The rate of public assistance matching was not increased for states with per capita incomes at least as high as the national average, while the rate was increased (from 50 percent to 65 percent) for states with per capita incomes below the national average. Public assistance grants had always been on a uniform basis in the past. Against the President's request, the maximum average welfare benefit payment to which the federal government would contribute was increased. Concerning the OASDI program, monthly benefits were increased by 7 percent, to be financed by increased tax rates and a 14 percent increase in the taxable ceiling. Further amendments

[1]Ibid., 157-158.

extended tax and benefit coverage. In particular, benefits were extended to dependents of disabled workers.[1]

An Overview of the 1950's

The keynote of the 1950's was program expansion and liberalization. Whereas the 1939 amendments served to mark the formal redirection of the social insurance titles of the Social Security Act, the many amendments enacted in the 1950's were devoted to increasing coverage (by extending the compulsory FICA tax to 9 out of 10 jobs), and increasing the number of persons currently eligible for benefits. In a series of amendments during the period, the age requirement for women workers, widows and wives were reduced. Also, new beneficiary categories were added, including benefits to the disabled, dependents and survivors of disabled workers, and husbands and widowers of women workers. Finally, the benefit computation period (the number of years elapsed over which the average monthly wage is calculated) was shortened signficantly by amendments enacted in 1950, 1954, and 1956.[2] As a result of the many liberalizations, thousands of persons became eligible immediately to draw benefits permanently, without any additional

[1]Ibid., 156-157.

[2]According to the 1935 Act, benefits were to be calculated on the basis of covered earnings accrued since the program commenced in 1937 until the time of retirement. In 1950, benefits were to be calculated on the basis of average covered earnings from 1950 until retirement. In 1954, workers were allowed to ignore four years of low earnings in their calculations, and in 1956, they were permitted to ignore five years. U.S. Department of Health, Education, and Welfare, Social Security Administration, History of the Provisions of OASDHI: 1935-1973, p. 3.

payments, and thousands were removed from the public assistance rolls.

There was a three-fold impact of these many liberalizations. First, real Social Security expenditures increased more rapidly than during any other decade in the program's history. As shown in Tables 29 and 30, between 1950-1960, real expeditures on the insurance titles alone, increased approximately 875 percent; and by 1960, 14.8 million Americans, or more than 8 percent of the population, were beneficiaries to the OASDI program. Second, the many liberalizations enacted in the 1950's created significantly more and larger future benefit claims that would have to be made good by a less rapidly growing number of covered worker-taxpayers--the potential gains from an intergenerational transfer scheme were being exploited. Whereas the real maximum individual tax payment increased 160 percent between 1950-1960, this was modest in contrast to increases forthcoming since the rapid expansion of coverage had allowed a spreading of tax costs.[1] Finally, as shown in Table 31, the stage had been set by the introduction of new beneficiary categories and the erosion of eligibility requirements for further expansion of the program. One could have predicted that demands would emerge very quickly to reduce benefit eligibility ages for widowers, as lower ages for women had created an "equity." Similarly, if benefits to disabled children of retired workers could be rationalized, so could benefits to disabled widows and widowers. Similarly, once age requirements had

[1]As a point of reference, the combined tax rate and taxable ceiling were only 5 percent and $4,800 ($8,856) in 1959. By 1976, the tax rate had reached 11.7 percent applied to $15,300 of taxable earnings.

TABLE 29

STATUS OF THE OASDI TRUST FUND: 1937-1960
(in millions of dollars)[a]

Year	Real revenues	Real expenditures	Real assets	Current Exp./ total assets
1937	$ 2,872	$ 3.7	$ 2,868	0.1%
1940	1,409	237	7,781	3%
1945	4,251	910	21,320	4%
1950	6,535	2,281	30,627	7%
1955	12,383	10,198	43,439	23%
1960	20,694	20,360	36,952	55%

SOURCE: Department of Health, Education, and Welfare; Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), p. 61.

[a]Calculated on the basis of 1975 prices.

TABLE 30

SELECTIVE BENEFICIARIES OF THE SOCIAL SECURITY PROGRAM
1940-1960

At end of yr.	Number of recipients of OASDI benefits	Number of recipients of OAA benefits[a]	As proportion of total population	
			OASDI	OASDI + OAA[b]
1940	222,488	2,070,000	0.1%	1.7%
1945	1,288,107	2,056,000	0.9%	2.5%
1950	3,477,243	2,786,000	2.3%	4.1%
1955	7,960,616	2,538,000	4.8%	6.4%
1960	14,844,589	2,305,000	8.2%	9.5%

SOURCES: Department of Health, Education, and Welfare; Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), pp. 60, 157.

U.S. Bureau of Census, The Statistical History of the U.S.: From Colonial Times to the Present (New York: Basic Books, Inc., 1976), p. 8.

[a]Old-age assistance (OAA) is a means-tested welfare program.

[b]Since some persons receive both OASDI and OAA benefits, these figures are slightly overstated.

TABLE 31

DEPENDENTS AND SURVIVORS BENEFICIARY CATEGORIES, BENEFITS AND MINIMUM AGE PAYABLE: 1939-1960

Date enacted	Benefits as a % of P.I.A. (and age payable)									
	Dependents of retired workers				Survivors					
	Wife	Child	Disabled child	Husband	Widowed mother	Widow	Child	Disabled child	Parent	Widower
1939	50%(65)	50%(18)[d]			75%	75%(65)	50%(18)[d]		50%(65)	
1950	50%(65)			50%(65)					75%(65)	75%(65)
1956	(62)[b]		50%(18)			75%(62)		50%(18)	75%(62)[c]	
1960							75%(18)[d]	75%(18)		

SOURCE: Department of Health, Education, and Welfare; Social Security Administration, History of the Provisions of OASDHI: 1935-1973 (Washington, D.C.: Government Printing Office, 1974), pp. 4-5.

[a]The primary insurance amount (P.I.A.) is based on the workers earnings history in covered employment and is the basis for benefit computations.

[b]Benefits actuarially reduced if granted before age 65.

[c]Age 62 is applicable for women only.

[d]Maximum age payable.

been reduced to acceptable limits, one could have predicted that demands would have emerged for special category benefit increases. Indeed amendments enacted during the 1960's introduced new beneficiary categories, reduced eligibility requirements, and increased benefits for most beneficiary categories.[1]

In all, the array of amendments enacted prior to 1960 simply laid the groundwork for what has been experienced since that time--the exploitation of the program for redistributive purposes by special interest groups, including Social Security officials, a rapid increase in individual tax costs, and the emergency of a "fiscal crisis" in the 1970's.

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[1]These benefit increases are entirely distinct from across-the-board benefit increases for all current recipients.

Chapter V

THE EXPLOITATION OF THE REDISTRIBUTIVE POTENTIAL AND THE GROWING COMPLEXITY OF THE PROGRAM: 1960-1975

Introduction and Summary

Although the entire legislative history of the Social Security program can be described as the gradual redirection and expansion of a limited objective old-age insurance program to a complex redistributive OASDHI program, there are certain important differences between its first twenty-five years and its following fifteen. First, the 1960's witnessed the emergence of a new social insurance program--Hospital Insurance--for which the objectives were contrary to those of the original Social Security program. The program was rationalized on poverty-alleviation arguments rather than on poverty-prevention arguments; and benefits were explicitly designed to be distributed independently of earnings and tax payments, rather than earnings-related. Second, the Kennedy-Johnson years elevated domestic policy, especially Social Security, to an annual political issue. The program was liberalized nearly every year between 1960-1976. Third, as shown in Table 32, across-the-board benefit increases were enacted between 1960-1975 that increased benefits to current recipients six times bringing the real increase since 1940 to 150 percent. Prior to 1960, only four across-the-board increases had been enacted, for a real cumulative increase

TABLE 32

COMPARISON OF PERCENTAGE INCREASES IN BENEFITS AND PRICES
FROM AMENDMENTS EFFECTIVE IN:

	1/40		9/50		9/52		9/54		1/59		1/65	
To:	Benefits	Prices	Benefits	Prices	Benefits	Prices	Benefits	Prices	Benefits	Prices	Benefits	Prices
9/50	77.0%	75.5%										
9/52	99.1	91.8	12.5%	9.3%								
9/54	125.0	92.8	27.1	9.8	13.0%	0.5%						
1/59	140.8	108.2	36.0	18.6	20.9	8.5	7.0%	8.0%				
1/65	157.7	124.7	45.5	28.0	29.4	17.1	14.5	16.5	7.0%	7.9%		
2/68	191.2	145.3	64.4	39.8	46.2	27.9	29.4	27.2	20.9	17.9	13.0%	9.2%
1/70	234.9	171.7	89.1	54.8	68.1	41.6	48.8	40.9	39.0	30.5	30.0	20.9
1/71	268.4	185.9	108.0	62.8	84.9	43.0	63.7	48.3	52.9	37.3	43.0	27.2
9/72	342.1	202.6	149.6	72.4	121.9	57.8	96.4	57.0	83.5	45.4	71.6	34.7
6/74	390.7	252.3	177.1	100.7	146.3	83.6	118.0	82.7	103.7	89.2	90.5	59.8
7/75	433.4	283.1	196.0	121.8	167.7	102.9	137.0	101.9	121.4	109.1	107.1	76.6

TABLE 32--Continued

	2/68		1/70		1/71		9/72		6/74	
To:	Benefits	Prices	Benefits	Prices	Benefits	Prices	Benefits	Prices	Benefits	Prices
9/50										
9/52										
9/54										
1/59										
1/65										
2/68										
1/70	15.0%	10.8%								
1/71	26.5	16.5	10.0%	5.2%						
9/72	51.8	23.4	32.0	11.4	20.0%	5.9%				
6/74	68.5	43.6	46.5	29.7	33.2	23.2	11.0%	16.4%		
7/75	83.2	48.7	59.2	43.3	44.8	36.1	20.7	28.6	8.7%	10.5%

SOURCE: U.S. Advisory Council on Social Security, *Report of the 1975 Advisory Council on Social Security* (Washington, D.C.: U.S. Department of Health, Education, and Welfare), Table A.

of 32 percent. Indeed, whereas total real social security expenditures increased more rapidly during the 1950's than during any other decade, it represented an increase that was largely absorbed by new beneficiaries of the program. During the 1960's and early 1970's, on the other hand, the 260 percent increase in real expenditures was reflected in large direct gains to current beneficiaries.[1]

What was the impact of the rapid program expansion and liberalization during the 1960's and 1970's? Rapid increases in the cost of the program, which had been begun during the 1950's, were finally reflected in dramatic increases in individual tax payments. Whereas the pre-1960 years were characterized by the rapid expansion of coverage which allowed the spreading of tax costs among individuals, by the 1960's, cost increases had to be absorbed by a less rapidly increasing stock of covered workers. Between 1940-1959, the real maximum tax payment increased 93 percent from $230 to $443. As shown in Table 33, between 1960-1976 alone, the real maximum tax payment had already increased 242 percent from $524 to $1,790.[2] Also, as Congress turned to real ceiling increases in lieu of large tax rate increases to finance additional expenditures, the rapidly rising costs were borne more heavily by higher income individuals.

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[1]Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, pp. 37-39. Figure includes expenditures, net of administrative costs, out of all three trust funds--OASI, DI, and HI--during 1960-1974, and is calculated on the basis of 1975 prices (as are all real figures in the study).

[2]Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 29.

TABLE 33

FINANCING SOCIAL SECURITY
1958-1977

Year act amended	Years effective	Maximum taxable earnings	Combined tax rate			Max. indiv. tax payment (1975 $)
			OASI	DI	HI	
1958	1959	$ 4,800	4.5%	.50%		$ 442
	1960	4,800	5.5	.50		523
	1961	4,800	5.5	.50		540
1961	1962	4,800	5.75	.50		534
	1963	4,800	6.75	.50		612
	1964	4,800	6.75	.50		604
	1965	4,800	6.75	.50		504
1965	1966	6,600	7.00	.70	.7%	919
	1967	6,600	7.10	.70	1.0	937
1967	1968	7,800	6.65	.95	1.2	1,063
	1969	7,800	7.45	1.10	1.2	1,117
1969	1970	7,800	7.30	1.10	1.2	1,039
	1971	7,800	8.10	1.10	1.2	1,079
1971	1972	9,000	8.10	1.10	1.2	1,205
1972	1973	10,800	8.60	1.10	2.0	1,497
1973	1974	13,200	8.75	1.15	1.8	1,686
	1975	14,100	8.75	1.15	1.8	1,650
	1976	15,300	8.75	1.15	1.8	1,705
	1977	16,500	8.75	1.15	1.8	1,790

SOURCE: Department of Health, Education, and Welfare, Social Security Administration, History of the Provisions of OASDHI: 1935-1973 (Washington, D.C.: Government Printing Office, 1974), p. 7; and Alicia H. Munnell, The Future of Social Security, Brookings Study in Social Economics (Washington, D.C.: The Brookings Institute, 1977), p. 86.

By 1975, the financial future of the Social Security program had finally become a matter of very serious political concern. In fact, during 1975, rather than legislating further expansionary amendments, Congress was devoting most of its attention to formulating politically acceptable (from both the demand and supply side) means of alleviating large trust fund deficits without jeopardizing the integrity of the many government "promises" outstanding.

It is the central purpose of Chapter V to address the question of what led to the political escalation of Social Security after the 1950's? Moreover, what economic and political factors help explain the introduction of large increases in real benefits payable under what had come to be known as an earnings-related insurance program? Why were additional expenditures financed increasingly by real taxable ceiling hikes rather than tax rate increases? In essence, what were the conditions or circumstances in the 1960's and early 1970's that led to a quite different set of political and institutional responses than had been the case in the first two decades of the program's history?

Foremost, by 1960, a complicated program had been created with multiple beneficiary categories and diverse eligibility criteria. The program had become far too complex to understand in its entirety, and the objectives of the program were no longer clear. Since the appropriate means to attaining an undefined objective are themselves poorly defined, almost any changes were defensible by Social Security bureaucrats and expansionist politicians. Discrimination against working wives was defended on the grounds that the OASDHI program had other goals than that of an insurance program; while earmarked taxes were defended on the grounds that the program was an insurance program. Real increases in minimum benefits were defended on the grounds that the program lacked "social adequacy" and did not provide a decent standard of living; while a means test was rejected on the grounds that it would conjure a redistributive welfare program and therefore be contrary to the objectives of an insurance program.

As a result, the piecemeal program became particularly susceptible to exploitation, whether demanded by special interest groups or "recommended" by Social Security officials. Changes enacted one year to bestow "deserving" groups with special benefits were offset in later years by demands for "uniformity." As representatives of the elderly, the poor, and organized labor became more dominant lobby groups, demands emerged for more adequate benefits and a redistribution of costs.

Importantly, without rules to protect minority coalitions, the introduction of a pay-as-you-go system in 1939 created an apparatus that would be particularly susceptible to overexpansion. With a system designed to make transfers predominately to the elderly, the age distribution and political power of the elderly would thus be key determinants of the ensuing expansion and income redistribution.

With regard to both of these variables, what is observed to have taken place, in fact, is not only a systematic weighting of the age distribution toward elderly persons, but also a startling increase, after the 1950's in the proportion of elderly persons who were direct recipients of dollar transfers from the Social Security Administration. Whereas the number of persons over sixty-five accounted for only 5.3 percent of the population in 1935, this figure had risen to 8.7 percent in 1955, 9.5 percent in 1965, exceeding 10 percent in 1975.[1] More important, perhaps, in explaining the quite different institutional and fiscal responses between 1960-1975, is the fact that in 1950, only 16.4 percent of all elderly persons were recipients of monthly OASDI benefits. Only ten years later, as shown in Table 34, 61 percent of the elderly were beneficiaries, and by 1970, this figure had reached 85 percent. Indeed, when one recognizes the relatively large incentive of beneficiary groups to actively participate in the collective choice process, as well as the incentives of elected representatives, these figures suggest a dramatic increase in the political power of the elderly.

The marked increase in the proportion of elderly persons in receipt of government funds was then met by a fairly significant increase in the number of all persons who were beneficiaries. Between 1950-1960, the total number of OASDI beneficiaries increased more than 300 percent, doubling in the next ten years. By 1974, there were 30.8 million recipients of monthly OASDHI benefits, accounting for 14 percent of the total population.[2]

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[1]U.S. Bureau of the Census, The Statistical History of the United States, p. 10.

[2]Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, p. 46.

TABLE 34

PROPORTION OF AGED AND TOTAL POPULATION RECEIVING
OASDHI OR OAA OR BOTH: 1940-1973

	Proportion of aged population receiving:		Proportion of total population receiving:	
Year	OASDHI	OASDHI or OAA or both	OASDHI	OASDHI or OAA or both
1940	.7%	24.4%	.01%	1.6%
1950	16.4	36.6	2.2	4.0
1955	39.4	53.9	4.7	6.2
1960	61.6	71.6	8.1	9.4
1965	75.2	81.7	10.7	11.7
1970	85.5	89.6	12.7	13.7
1973	86.7	90.0	14.2	15.0

SOURCES: Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, pp. 46, 64; Social Security Bulletin: Annual Statistical Supplement, 1973, p. 50; Social and Rehabilitative Service, Trend Report: A Graphic Presentation of Public Assistance and Related Data (1969), p. 41; and U.S. Bureau of Census, Historical Statistics of the U.S., p. 10.

Another factor that must be considered important in accounting for the marked expansion and redirection of Social Security after 1960 was the rapid increase in state welfare expenditures, particularly with the introduction of disability (1950) and medical (1960) assistance. Recall that the various means-tested assistance programs, as created in 1935, were state administered programs financed with federal matching funds. Even recognizing the increasing role played by the federal government in financing these programs, state expenditures increased 256 percent between 1960-1973, as compared to only 16 percent in the preceding decade.[1]

A natural outgrowth of this development was the emergence of bipartisan support for increases in the minimum benefit payable under the insurance titles of the Social Security Act. Indeed, certain key Congressmen with typically conservative voting records emerged as outspoken proponents of an expanded role for social insurance relative to public assistance as this represented a very direct means of reducing oppressive state welfare expenditures.[2] Increases in the minimum

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[1]Real state and local expenditure data; see Table 36.

[2]For example, Russell Long (D.-La.), Chairman of the Senate Finance Committee, was an ardent supporter of increasing minimum OASDI benefits and liberalizing eligibility, policies which tended to transfer costly state welfare responsibilities to the federal insurance titles of the Social Security program. His stands are not surprising when one realizes that in 1973, Louisiana ranked second in the country for the number of elderly receiving old-age assistance and fifty-first in the country for the number receiving OASDHI benefits. In Louisiana, 328 out of 1,000 elderly people were receiving old-age assistance in 1973, compared to the national average of 89 out of 1,000. See Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 50.

benefit payable, financed by a near-nationally imposed payroll tax, dispersed tax costs and took hundreds of thousands of elderly persons off state welfare rolls.[1]

Finally, the presence of responsive administrations in the 1960's, during which time Presidents Kennedy and Johnson elevated domestic policy to a national priority, produced an environment conducive to demands by expansionary special interest groups. Just as the Roosevelt years exposed the redistributive potential of government institutions, income redistribution was an explicit policy goal of both Kennedy and Johnson. Unlike the 1930's, however, key social insurance advocates were now a part of the Social Security bureaucracy, with the largest public information service in the world at their disposal.

For each of these reasons, the Social Security program expanded to encroach upon traditionally state welfare activities, traditionally private insurance activities, and upon the rights of future workers.

In essence, what has been observed during the past fifteen years is the predictable outcome of: (1) eliminating effective constraints on the demand of special interest groups, by eliminating the individual equity benchmark and the fully funded program; and (2) increasing supply side control over informational sources by expanding the scope of the Social Security Administration's activities. The "fiscal crisis" observed in 1975 and 1976, is the result of finally perceiving, through

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[1]In 1940, 21.7 percent of the elderly were receiving old-age assistance. This proportion fell steadily, reaching 8.9 percent in 1973. See Ibid.; see also Table 37.

competing sources of information, a binding budget constraint--coverage is almost universal and tax rates are reaching their politically acceptable limits. Indeed, large trust fund deficits brought about by unexpected increases in expenditures and adverse demographic trends have threatened the ability to postpone tax increases to future generations of workers.

The Kennedy-Johnson Years: 1960-1968

During the 1960's, amendments to the Social Security Act were legislated by Congress in each year except 1964 and 1968. As enacted, the many amendments greatly exacerbated the mounting complexity of the program--complexities that were bound to lead to further liberalizations for "adequacy" and "equality" of treatment. Moreover, the introduction of Medicare in 1965 greatly expanded the scope of the federal government's powers over traditionally private sector activities, and redirected the program from its initial insurance objective.

The net result of the program changes enacted between 1960-1968 was a doubling of both the number of beneficiaries to the Social Security program and the real maximum individual tax payment. By 1968, total expenditures on the insurance titles of the Act reached $30 billion ($46.4 billion) and nearly 20 percent of the voting age population were direct beneficiaries to the OASDHI system.[1]

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[1]Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, pp. 61-63; and Social Security Bulletin, Vol. XL, No. 5, p. 46.

A Brief History of the Compulsory Federal Health Insurance Movement

Until the enactment of Medicare in 1965, the health insurance, or hospital insurance, issue dominated all other issues of Social Security in the early 1960's. Indeed, the compulsory program for federal medical and hospital insurance was ultimately enacted against bitter opposition from Republicans, conservative Democrats, and the American Medical Association (AMA), and marked the end of a battle that had begun early in the 1900's.

The health insurance movement, which dated to the first decade of the twentieth century, was led by the American Association of Labor Legislation--the same organization of academics that sustained the entire social insurance movement. Demand-side opposition to compulsory health insurance had been at least as adamant as to any other form of compulsory social insurance. Federal health insurance was simply contrary to private sector reliance and voluntary organization and threatened to socialize yet another aspect of private sector activity.[1]

As early as 1920, the AMA House of Delegates declared its opposition to the "institution of any plan embodying the system of compulsory contributory insurance against illness," or which "provided for medical service," whether "provided, controlled, or regulated by any state or federal government."[2] Moreover, just as had been the case

[1]For a statement of this view, see Frederick von Hoffman, More Facts and Fallacies on Compulsory Health Insurance (Newark: Prudential Press, 1919).

[2]Cited in Theodore Marmor, The Politics of Medicare (Chicago: Aldine Publishing Co., 1970), p. 7.

with the early old-age insurance movement, advocates of health insurance found intense labor opposition particularly distressing. Prior to 1930, Samuel Gompers, President of the AFL, opposed all forms of compulsory social insurance.[1]

Although the onset of the Great Depression marked a change in attitude toward the federal provision for old-age security, the same was not true for health insurance. When the President's Committee on Economic Security made its report in 1935, the only reference to health insurance was the recommendation to have the newly created Social Security Board study the issue. The suggestion drew such heated attack that the reference was deleted altogether from the bill as enacted eight months later.[2]

It was not until 1945 that President Truman reopened the health insurance issue by endorsing the pending Wagner-Murray-Dingell Bill for compulsory health insurance. In Truman's State of the Union Address, 1948, he expressed again his desire to see enacted "a comprehensive insurance system which would remove the money barrier between illness and therapy . . . protect all people equally."[3]

The demands of the Social Security bureaucracy, early advisory councils, and key lobby groups including the American Association of

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[1] Organized labor's early opposition to compulsory social insurance is discussed by Daniel Sanders in The Impact of Reform Movements on Social Policy Change: The Case of Social Insurance, pp. 131-134; and Roy Lubove, The Struggle for Social Security. pp. 15-18.

[2] Theodore Marmor, The Politics of Medicare, p. 8.

[3] Ibid., p. 10.

Retired Workers, the National Association of Social Workers, and the Socialist Party, however, were not sufficient to arouse the conservative post-war Congress.[1] Backed by the AMA, the American Hospital Association, the Chamber of Commerce, and others, the predominately Republican Congress was no more inclined to support demands for encroachment in the health care industry than it had been to support expansionism with regard to the existing titles of the Social Security Act.

In response to the clear inability to muster popular support for health insurance during the 1940's and 1950's, health insurance advocates sought new means of packing their proposals. Since comprehensive health insurance proposals had been condemned not only for being a step toward socialism, but also for failing to distinguish between the deserving and non-deserving poor, more "modest" programs were proposed which would have restricted coverage to OASDI recipients, and they were renamed, less offensively, "hospital insurance" plans.

No action was taken in the 1950's, but as the number of elderly persons who would have been pure gainers from the tying of hospital insurance to the OASDI program increased by fivefold during the decade,

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[1]Ibid., pp. 23-24; and for a further discussion of lobby stands on health insurance, see Congressional Quarterly Almanac, Vol. XVI, p. 164.

considerable interest was generated. Between 1958-1965, Congress annually held hearings on health insurance.[1]

By the time health insurance proposals emerged in the late 1950's as important political issues, organized labor and HEW officials were the most active and influential advocate-lobbyists. Most notable among these were Nelson Cruickshank, Head of the AFL-CIO Department of Social Security; Isidore Falk, consultant to the UMW; Wilbur Cohen, appointed Assistant Secretary of HEW in 1961; and Robert Ball, a career official with the Social Security Administration. It had been the intention of these four advocates to attract union support for health insurance legislation through the AFL-CIO and Congressional support through a powerful congressional sponsor. Representative Forand (D.-R.I.), who sponsored the first major compulsory health insurance bill in 1960, was the fourth ranking Democrat on the House Ways and Means Committee.[2]

The first headway was made toward compulsory, federal health insurance in 1960.

The Amendments of 1960: The First Headway Toward Health Insurance

Health insurance was the major issue of debate during the hearings that led to the 1960 Amendments to the Social Security

[1]During the 1950's, there were three plans that gained considerable attention: President Eisenhower's proposals to either reinsure private companies against heavy losses on health insurance, or to permit small insurance firms to pool their assets; and Rep. Aime Forand's (D.-R.I.) plan to provide hospital care to the needy aged, financed by an increase in the payroll tax. See Congressional Quarterly Weekly Report (1965), p. 1494.

[2]Theodore Marmor, The Politics of Medicare, p. 30.

Act.[1] This was inevitable as 1960 was a presidential election year, and both Vice President Richard Nixon and Democratic presidential nominee John F. Kennedy had endorsed widely different proposals. Hearings, which commenced in 1959 and continued through 1960, were held on a wide array of alternative proposals. As diverse as the proposals were, however, they all had one goal in common--the "essential objective of achieving the cost spread for aged medical care through governmental action, that is, through compulsory taxation."[2] Conservatives generally supported some type of means-tested medical aid program administered at the state level. Liberals advocated federal compulsory health insurance.

During early hearings in the House Ways and Means Committee, the Forand bill (HR4700) was the center of debate, a bill which would have created a compulsory federal hospital insurance program financed by the payroll tax.[3] The bill had considerable support from liberals and, in fact, was submitted in the Senate in essentially the same form by presidential nominee John F. Kennedy (D.-Mass.).

Echoing conservative sentiments, Arthur Flemming, Secretary of HEW, testified at the hearings against the Forand bill. Flemming recognized that the bill would lead to a "virtual halt in the growth of voluntary insurance efforts" and would have "far-reaching and irrevocable consequences."[4] Representative Wilbur Mills (D.-Ark.), Chairman

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[1]For a discussion of the legislative developments preceding the 1960 Amendments, see Congressional Quarterly Almanac, Vol. XVI, pp. 148-165.

[2]Ibid., p. 152. [3]Ibid., p. 153. [4]Ibid.

of the House Ways and Means Committee, who was to become a leading opponent of compulsory health insurance, echoed a more moderate stance by opposing any changes in Social Security that might have led to higher taxes.

When hearings recommenced in March of 1960, Flemming reiterated his opposition, saying "we will oppose any program of compulsory health insurance," preferring instead to develop a plan that would not stifle private initiative.[1] On March 30, the growing health insurance movement suffered a major setback when President Eisenhower finally took a formal stand on the issue. He said that "compulsory insurance" was a "very definite step toward socialized medicine," and "I don't want any of it."[2]

A month later, Flemming presented to the Ways and Means Committee the Administration's counter-proposal which included two federal-state programs between which the individual could have had a choice. Under one state administered plan, the elderly would have been eligible for an array of medical services by paying an annual premium, and states would have been authorized to employ private insurance companies as administrative agents. An alternative to this would have been a program with federal-state subsidies for private insurance policies.

Reactions to the Administration's bill were mixed. Senator Barry Goldwater (R.-Ariz.), representing staunch conservatives, said that despite their voluntary and decentralized nature, the plans were still steps toward socializing medicine. Moderates and liberals

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[1] Ibid., p. 153. [2] Ibid., p. 148.

generally agreed the plans would not have gone far enough in aiding the elderly. During May, Senator Pat McNamara introduced a bill (S 3503), co-sponsored by Kennedy and eighteen other Democratic Senators similar to the Forand bill but which provided benefits not only for persons eligible for Social Security but others as well.

In the House Ways and Means Committee, the McNamara-Forand type bills were far too liberal, and the Administration's bill was slightly too conservative. As such, the Committee voted to have an alternate health care plan drafted. Submitted by Chairman Mills, the plan proposed establishing a federal-state program giving states more flexibility than under the Administration's plan. When reported, the bill (HR 12580) contained most of the elements of the more modest Mills bill as well as various liberalizations of the OASDI provisions of the Social Security program. By August, the Senate Finance Committee had approved HR 12580 with amendments to liberalize the House plan for a federal-state medical care program. On September 13, 1960, the 1960 Amendments were signed into law (PL 86-778) by President Eisenhower.[1]

As enacted, the 1960 Amendments provided a system of federal grants to the states for medical aid to not only the needy but also the ill-defined "medically needy." On a non-uniform basis, federal grants

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[1]For detailed discussions of the 1960 Amendments, see Congressional Quarterly Almanac, Vol. XVI, pp. 148-150; Wilbur Cohen and William Habar, "The Social Security Act Amendments of 1960: An Analysis of the Provisions of the Legislation and Its Potentialities," in Social Security: Programs, Policies, and Problems, pp. 579-591; and Social Security Administration, History of the Provisions of OASDHI: 1935-1973, pp. 1-11.

were to be made available to states providing medical care to the needy aged eligible for public assistance. The grants were to range from 50 percent to 80 percent, applied up to a maximum of $12 ($22) per recipient per month. A second plan for the "medically needy," those persons with incomes too high to qualify for old-age assistance but deemed in need of medical assistance, provided federal grants of 50 percent to 80 percent, but without a maximum payment stipulated. Changes in the OASDI program included a liberalization of the retirement test and benefit eligibility requirements, and an increase in benefits to surviving children. Social Security coverage was extended and the age 50 requirement for disability insurance was eliminated.

As such, the 1960 Amendments marked a continued liberalization of the Social Security program, and continued centralization of activities. The enactment of medical care assistance, although introduced as a defense against a compulsory, centralized system of health insurance, provided a stronghold for social insurance advocates and for the eventual extension and centralization of the program. Just as payments had been made to the disabled on a federal-state matching basis in 1950, followed by compulsory disability insurance in 1956, only four years after the establishment of medical assistance at the federal-state level, Medicare and Medicaid were enacted. Indeed, the inevitable rise in state welfare costs, particularly due to the inclusion of the ill-defined medically-needy, would eventually generate more general demands for a national compulsory system as a means of dispersing tax costs.

The Amendments of 1961: Redistribution

On February 2, 1961, newly inaugurated President Kennedy called for an increase in both Social Security benefits and the payroll tax rate. As his proposals were sent to Congress, he remarked that the changes would "give our economic recovery program needed impetus," and "place increased purchasing power in the hands of almost five million people."[1] The chief proponent of the Administration's recommendations was Abraham Ribicoff, Secretary of HEW.

On June 30, 1961, only nine months after the enactment of the 1960 Amendments, President Kennedy signed into law the Social Security Amendments of 1961 (PL 87-64).[2] The amendments, somewhat less extensive than requested, included: a 20 percent increase in the minimum OASDI benefits payable, a reduction in the retirement age for men to 62, an increase in widows' benefits from 75 percent to 82-1/2 percent, and a liberalization of benefit eligibility requirements and the retirement test. The Social Security payroll tax schedule was increased less than requested by the President. Finally, the existing formula for federal participation in public assistance grants was increased again. The cost of these revisions was estimated to be $800 million ($1.4 billion) for the first year in effect.

The 1961 Amendments were indicative of the response to a program

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[1] Congressional Quarterly Almanac, Vol. XVII, pp. 258.

[2] For more detail on the 1961 Amendments, see Ibid., pp. 257-261; and Wilbur Cohen, "Summary of the 1961 Amendments to the Social Security Act," in Social Security: Programs, Problems, and Policies, pp. 593-595.

which is, by nature, piecemeal and redistributive. As suggested earlier, when amendments are enacted that specify special age requirement or benefit formulas for particular types of beneficiaries, the stage is set for future expansion of the program. Demands for "equality" and "uniformity" emerge to offset the original demands for special treatment for particularly deserving beneficiaries. Also, increases in the minimum monthly benefit, holding other benefit levels constant, clearly had the effect of infringing on the welfare role of the federal-state public assistance program. Such a change in conjunction with an increase in the federal rate of public assistance matching, led to the continued centralization of traditionally state welfare activities and a complication of the welfare-insurance objectives of the OASDI program.

Amendments to the 1962 Public Welfare Amendments

While the 1950's were marked by the enactment of Social Security amendments every two years, on election years, 1962 marked the third consecutive year in which revisions were made in the Social Security law. In 1962, no changes were made in the OASDI program, but the enactment of a fairly extensive welfare program incorporated changes in the public assistance titles of the Social Security Act.

The Public Welfare Amendments of 1962 (HR 10606), recommended by President Kennedy on February 1, requested increases in aid to the needy as well as the introduction of rehabilitation programs designed to reduce future public assistance costs.[1] The conservative opposition

[1] See Congressional Quarterly Almanac, Vol. XVIII, pp. 212-218.

to increasing the federal government's role in the federal-state welfare program was aptly summarized by views expressed by the Republican members of the House Ways and Means Committee when they said it was leading to an "ever-increasing federalization of what should be inherently state programs."[1]

With Secretary of HEW Ribicoff as the Administration's leading lobbyist for the bill, however, it passed Congress with little serious debate during an election year. As signed into law (PL 87-543) on July 25, the federal share in public assistance was increased for the tenth time since the Social Security Act was enacted in 1935.

The Amendments of 1965: Compulsory Federal Hospital Insurance

In 1965, President Johnson saw enacted comprehensive compulsory health insurance in the United States. Unlike most amendments to the Social Security Act, the program was unable to muster universal acceptance by a bipartisan group of Congressmen.[2]

Since the defeat of the compulsory health insurance in 1960, advocates had continued their efforts to package and sell their programs.

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[1]Ibid., p. 216. The federal share in financing the welfare programs had been increased in 1939, then every 2 years from 1946-1960, and again in 1961.

[2]The conference report, which also included hospital insurance, an expanded program of grants to the states for medical assistance to the needy aged, and an increase in Social Security benefits was supported by House Republicans by a narrow margin (70-68), and opposed by Senate Republicans (13-17). See Congressional Quarterly Weekly Report (July 30, 1965), p. 1493. Recall that disability insurance passed the Senate by a one vote margin; see Wilbur Cohen, "The Social Security Amendments of 1960," in Social Security: Programs, Policies, and Problems, ed. by Wilbur Cohen and William Habor, p. 592.

In 1963, President Kennedy submitted a "Special Message on Aiding Our Senior Citizens" with a proposal for compulsory federal hospital insurance. The proposal was designed to provide insurance benefits to older people for whom private insurance was relatively expensive, to be financed by a 1/2 percent increase in OASDI tax rates and an increase in the tax base (from \$4,800-\$5,200).[1] The Administration's recommendations were introduced into Congress during February of 1963 by Representative Cecil King (HR 3920) and Senator Anderson (S 880), but no action was taken.

Prior to the elections of 1964, President Johnson suffered a major legislative defeat when proposals for implementing a compulsory medicare program died in Congress. Since, however, the plan had been passed by the Senate for the first time in history and, importantly, a cost-of-living increase in Social Security benefits had been tied up until the next session of Congress, the prospects of passing a "package" during the next session were more likely.

As had been the case historically, health insurance proposals were unable to make it out of the House Ways and Means Committee. Representative Wilbur Mills, Chairman of the Ways and Means Committee, was generally considered the leading Congressional opponent and major stumbling block to enactment. In a speech, September 28, 1964, Representative Mills explained his opposition to the proposed plan. In

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[1]In the words of President Kennedy, the proposal was based on the "fundamental premise that contributions during the working years, matched by employers' contributions, should enable people to prepay and build earned rights and benefits to safeguard them in their old age." Congressional Quarterly Almanac, Vol. XIX, p. 234.

essence, he firmly opposed any changes in the Social Security program that would have diminished the financial soundness or integrity of the Social Security funds. For that reason, he was particularly critical of the Administration's cost estimates for understating the true cost of the program.

> I have always maintained that at some point there is a limit to the amount of a worker's wages or the earnings of the self-employed person, that can reasonably be expected to finance the Social Security system . . . . One of the difficulties that has actually impeded the reaching of a sound solution (to the medical needs of the elderly) is the insistence by proponents of medical care on proceeding toward a solution through the existing OASDI system.[1]

In contrast, advocates generally praised the benefits of a compulsory health insurance program without regard for cost. Indeed, it was becoming easy to dismiss million or billion dollar increases in annual expenditures as only a small percentage increase in tax payments. Voicing the views of advocates during the 1964 hearings, Anthony Celebrezze, Secretary of HEW, said that serious illness was a "major threat to the financial security and peace of mind of our older citizens" and that the Administration-backed King-Anderson Bill (HR 3920) was the most effective means of providing needed security. Private insurance, he said, had not met this need.[2]

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[1]The Administration's cost estimates were based on the erroneous assumption that hospital costs would increase at the same rate as earnings; see Ibid., pp. 231-232. In fact, as late as 1971, this method of estimating costs had not yet been eliminated. See "Report by the Panel of Actuaries to the Subcommittee on Cost Estimates and Financial Policy," in the Report of the 1971 Advisory Council on Social Security (Washington, D.C.: U.S. Department of Health, Education and Welfare, 1971), p. 124.

[2]Congressional Quarterly Almanac, Vol. XX, p. 232.

On June 24, the House Ways and Means Committee postponed action on the King-Anderson Bill (HR 3920) as it was clear opposition was still too strong. The Committee, however, reported a bill (HR 11865) to increase Social Security benefits by 5 percent and extend benefit coverage. The additional expenditures were to be financed by an increase in tax rates and the taxable ceiling. Representative King admitted that benefit increases had been restricted to 5 percent since any additional increases, with concomitant tax and ceiling increases, would have made the introduction of a costly health insurance program in the future less likely.[1]

It was not until the bill reached the Senate Floor that it was amended to include a medicare program. The amendment, sponsored by Albert Gore (D.-Tenn.),was of little avail, however, as the House-Senate conferees were unable to come to a compromise on medicare before the 88th Congress ended. It was generally believed that the Senate was unwilling to compromise its demand for medicare as the enactment of a Social Security benefit and tax increase in 1964 would have reduced the likelihood of passing a costly medicare program-Social Security benefit hike package in 1965.[2]

In 1965, after being elected in 1964, President Johnson's energies were directed to domestic policy and the "Great Society." Only three days after his State of the Union address, Johnson presented a "Health Message," calling once again for compulsory hospital insurance for Social Security recipients, financed by Social Security taxes (or,

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[1] Ibid., p. 234. [2] Ibid., p. 239.

in his words, "modest contributions during working years").[1] For those not covered by Social Security, hospital care would have been financed by general revenues.

The President's hospital insurance proposal was embodied in the first bill introduced into the 89th Congress (HR 1), with an estimated first year cost of $2 billion ($3.4 billion). To appease Representative Mills, said an Administration official, cost estimates had been based on the assumption that medical costs would increase faster than earnings, the program would be financed through a separate fund, and the payroll tax deducations applicable to hospital insurance would be designated separately on the W-2 form, distinct from OASDI deductions.[2] The bill had support, most notably, from the Secretary of HEW, northern Democrats, and organized labor.

Long-time opposition to hospital insurance was led by Congressional Republicans, conservative Democrats and the AMA--out of which emerged three major defensive bills, all of a voluntary nature and providing more generous benefits.[3] The AMA plan, introduced by Representatives Sydney Herlong (D.-Fla.) and Thomas Curtis (R.-Mo.), was a voluntary plan for the needy aged to be integrated into the Kerr-Mills federal-state grants program. The elderly aged who purchased health insurance privately would havehad their premiums set according to income,

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[1]Ibid., Vol. XXI, p. 54.

[2]Ibid., p. 39. The changes would not, in fact, have provided for separate financing because part of the cost was to be met through taxable ceiling increases on which OASDI taxes were payable.

[3]Ibid., pp. 66, 340.

subsidized by federal-state revenues. A similar plan was introduced by Senator Leverett Saltonstall (R.-Mass.). Finally, Representative John Byrnes (R.-Wisc.), ranking minority member of the House Ways and Means Committee, proposed a more expensive voluntary plan with graduated premiums to be financed by federal-state revenues plus individual contributions.

By July, 1965, with the support of a 2:1 Democratic Congressional majority, HEW officials, and the 1965 Advisory Council on Social Security, Medicare was enacted, despite vigorous opposition by conservatives, business and insurance interests, and the AMA.[1]

The new provisions, incorporated into Title XVIII of the Social Security Act, created two plans: a compulsory hospital insurance plan, Part A; and a supplemental voluntary plan to cover doctor's bills, Part B,[2] with some deductibles and co-insurance terms, hospital insurance covered the cost of:

(1) 90 days of hospital care for each spell of illness.

(2) 100 days of post-hospital care.

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[1]The bill passed the House by a vote of 307-116 and the Senate by 70-24; see Congressional Quarterly Weekly Report (July 30, 1965), p. 1493. The 1965 Advisory Council on Social Security recommended instituting hospital insurance, increasing the number of years during which children would be eligible for benefits, increasing the taxable ceiling, weighting the benefit formula toward lower income persons, and expanding coverage to doctors. All of these recommendations were enacted in 1965. See U.S. Advisory Council on Social Security, Status of the Social Security Program and Recommendations for its Improvement (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1965).

[2]For more detail on the 1965 Amendments, see Congressional Quarterly Weekly Report (July 30, 1965), pp. 1493-1500; Theodore Marmor, The Politics of Medicare, p. 73.

(3) 20 days of outpatient diagnostic services.

(4) 100 days of home care visits.

The program was to be financed by an increase in payroll tax (not to exceed 1.6% in 1987 and thereafter) and an increase in the taxable ceiling.

The supplementary program was designed to pay 80 percent of the elderly recipient's costs associated with the services of doctors and other medical specialists, 100 home care visits, and other health and medical services. This program was to be financed by a monthly $3 premium matched by a federal government contribution from general revenues.

Additionally, Medical Assistance for the Aged (MAA) increased federal grants to states and was to be applicable on a state optional basis. MAA was to be payable even to persons not eligible for old-age assistance; that is, a "flexible" means test was to be utilized in determining eligibility.

In the same law, additional changes were made in the OASDI program. Benefits were increased 7 percent, children's and widows' benefits were made payable for a longer period of time (by raising the cut-off age for children from 18 to 21, and by reducing the eligible age for widows from 62 to 60), and coverage was expanded. Eligibility requirements for disability insurance were significantly reduced, and special lenient eligibility requirements were instituted for persons at least 72. The tax rate and nominal taxable ceiling were both increased.[1] The first year costs of the bill were estimated at $6.5 billion ($11 billion).

HI and OASDI: Similarities and Differences

Several remarks are warranted on the significance of the 1965 Amendments to the Social Security Act. First, attempts by liberal Congressmen and Social Security officials to sell Congress on health insurance had failed repeatedly from 1940 to 1964, until the issue was raised as a political one--the issue of providing the millions of elderly an array of medical services at a fraction of their costs. Despite the growth and development of private voluntary medical insurance plans, it was indeed difficult to curb the momentum behind a program that would make 19 million elderly persons eligible for benefits, at no cost, the day it was officially launched.[2]

As had been the case in the 1930's with old-age insurance, the Administration had brought to focus the high cost of private insurance for the aged and needy, and there resulted a registered demand, particularly by the elderly, for federal action of some type. Again, the Administration responded with a comprehensive, federal system of hospital insurance. Moreover, just as the old-age insurance program had been effectively tied to the creation of politically appealing poverty relief programs in the 1930's to ensure the passage of the former, the

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[1]The taxable ceiling did not exceed, in real terms, its 1935 level until 1968.

[2]Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 147.

non-earnings-related Medicare program was tied to the politically popular OASDI program.

Unlike during the 1930's, the rationales for the program did not include the safety of government programs from depression-oriented financial failure, or myopia arguments that concluded that people needed to be compelled to purchase insurance throughout their working lives to prevent them from becoming a charge on the state at a future date. Instead, the program was supported on the basis of welfare-alleviation arguments, and the need to fill a "major deficiency" in the existing program. Rather than stress preventive insurance for the future, Medicare and its advocates stressed alleviation of "medical poverty" through income (or cost) redistribution.

Also, unlike the other two forms of social insurance (OASI and DI), Medicare benefits were not intended to be earnings related. Granting that the tax-benefit link had become less direct over time, OASDI benefits were still positively related to earnings, as the programs had been designed to offset the loss of income associated with old-age or disability, losses which are by definition earnings related. This was not at all the case with hospital insurance. Everyone covered by Medicare was eligible for exactly the same benfits. Benefits were in no sense earnings-related, yet the program was financed by an earnings related tax.

The enactment of the Medicare program thus increased many-fold the complexity of the Social Security program and set the stage for an infinite array of possible extensions. The nature of the political process and bureaucratic incentives would have led one to predict a reduction in the seemingly arbitrary eligibility requirements, co-insurance terms, and deductibles, as well as an increase in the number of benefit days. Also, an extension of types of medical benefits, and an increasingly federal Medicaid program could have been predicted to evolve over time.[1] Finally, since the new Medicare program was not earnings-related, one of the last constraints on employing the Social Security program as a vehicle for redistributing income had been eliminated. It should not be surprising that by 1976, health insurance for all ages was being demanded.

An Amendment to the 1966 Tax Adjustment Act

Enacted March 15, 1966 (PL 89-368), President Johnson's Tax Adjustment Act was designed to provide additional funds for the Viet Nam War and impose, in his words, "fiscal restraint to balance our economic expansion."[2]

The Tax Adjustment Act of 1966 included an amendment to the Social Security Act that introduced most explicitly a welfare benefit to persons over 72. The Social Security amendment, which was introduced unexpectedly by Senator Winston Prouty (R.-Vt.), called for

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[1] The National Council of Senior Citizens, an active lobby group for Social Security which numbered 2 million in 1965, was already demanding an elimination of deductibles and coinsurance terms, the extension of the program to cover prescription drugs, and the extension of Medicare benefits to the disabled. See Congressional Quarterly Almanac, Vol. XXII, p. 1300.

[2] Congressional Quarterly Weekly Report (1966), p. 633. See also Ibid., pp. 547, 589.

minimum monthly benefits to all persons at least 70 years of age who were not currently eligible under Social Security. The proposed amendment led to heated debate, yet when modified and attached to the Tax Adjustment Act during an election year, it passed with the rest of the Act.

As amended, liberalized benefits for persons at least 72 (enacted in 1965) were further liberalized so that anyone at least 72 was eligible for a $35 monthly payment (plus $17.50 for a spouse) to be financed from the OASDI trust fund, effective October 1, 1966. Beginning in 1968, the special age 72 benefits were to be financed from general revenues, and only payable to persons with some previous covered employment.

Aside from the redistributive implications of the special age 72 benefits, the passage of the Tax Adjustment Act was important to the future developments in Social Security for another reason. This represented the first time OASDI amendments were tied to pending non-germane legislation to insure their passage. This tactic was used again in 1969, 1971, 1972, and 1973.

1967 Amendments: Costly Expansion

The last major revisions of the Social Security Act during the Johnson Administration were incorporated in the Social Security Act Amendments of 1967. The Amendments represented a modified, although still expensive version of the proposals made by President Johnson on January 23, 1967. At that time, he requested a 20 percent increase in Social Security benefits, on average, a 59 percent increase in minimum benefits, and further liberalization of the program.[1]

Hearings began on revising the Social Security Act in March with a 35 page explanation and endorsement of the Administration-backed bill (HR 5710) by John Gardner, Secretary of HEW. Issues of debate centered around not only the cost of the proposed program, but also its "adequacy." Both Robert Ball, Commissioner of Social Security, and Wilbur Cohen, Under-Secretary of HEW, expressed concern over the political desirability of increasing the payroll tax rates. Conservatives questioned the advisability of significantly increasing minimum benefits simply to reduce the number in poverty as this objective was inconsistent with the purpose of the Social Security Act. The AFL-CIO, UAW, National Council of Senior Citizens, and the National Association of Social Workers all endorsed the Administration's recommendations, but desired larger benefit increases. Walter Reuther of UAW and representatives of the National Association of Social Workers both called for a 50 percent increase in OASDI benefits and an eventual increase in the taxable ceiling to $15,000 ($24,193).[2]

The Administration's bill (HR 5710), introduced by Representative Mills, also called for extending Medicare benefits to the disabled

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[1] Congressional Quarterly Weekly Report (January 27, 1967), pp. 124-125. By the time the 1967 benefit increases became effective in February, 1968, prices had risen 9.2% since the last benefit increase in January, 1965. See Table 32.

[2] For more on lobby stands, see Congressional Quarterly Weekly Report (1967), pp. 340-341, 497-498, and 590-591. The taxable ceiling was currently $6,600 and benefits had already been increased more than 33 percent in real terms since 1940.

under 65 years of age. To this, the AMA reiterated its opposition to the Medicare program, which had been officially launched July 1, 1966, the likely impact of increased demand on medical costs, and the perverseness of subsidizing medical care to the non-needy.

While the House Ways and Means Committee reduced significantly the scope and cost of the amendments proposed by Johnson, the Senate, where Johnson had presided only 6 years earlier, approved a huge program, the cost of which was estimated at $7 billion ($11.3 billion) during the first year alone.[1] As the bill (HR 12080) made it through the conference committee and was cleared by Congress, the costs of the program had been reduced to $3.6 billion, Social Security benefits were increased across-the-board 13 percent, special age 72 benefits were increased 15 percent, and the retirement test was liberalized. Also, benefits were extended to disabled widow(er)s at age 50, additional benefits were provided to children, and disability benefits were extended to persons under 31.[2]

In addition to these changes, ceilings were imposed on federal Medicaid expenses, as the costs had far exceeded those estimated by the Secretary of HEW. To curtail some of the rapid cost increases, the 1967 Amendments stipulated that the federal government would not participate with state programs if persons with incomes greater than

[1] Committee on Ways and Means, U.S. House of Representatives, Summary of Provisions of HR 12080: The "Social Security Amendments of 1967," 90th Cong. (August 7, 1967).

[2] See Congressional Quarterly Weekly Report (December 22, 1967), pp. 2598-2601, for the major provisions.

150 percent of the state's income cut-off for public assistance recipients were permitted to receive Medicaid. This was an attempt to put some limit on the number of "medically needy" families receiving Medicaid and not eligible for other forms of public assistance. This income stipulation was to be gradually reduced to 133 percent in 1970. If persons with incomes greater than 133 percent of the state's income cut-off for other forms of public assistance were still eligible for Medicaid, the state would lose its funds.

The Choice Between Fiscal Instruments

The means chosen to finance the large increases in OASDHI expenditures would prove to be crucial to future developments. Specifically, scheduled tax rates were increased, but not until four years hence. To finance immediate cost increases, the taxable ceiling was increased from $6,600 ($10,645) to $7,800 ($12,580)--the first real ceiling increase in the history of the program from the 1935 ceiling of $3,000 ($11,235).[1] Once employed, increases in the real taxable ceiling were legislated regularly by Congress. As such, it is naturally a curious phenomenon that real ceiling increases were not employed earlier.

An understanding of this phenomenon requires an examination of the trade-off between alternative fiscal instruments. Within the confines of the given institutional structure, there have existed three primary means of financing additional Social Security expenditures: tax

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[1]See Table 33 for the maximum individual tax payment, 1958-1976.

rate increases, real taxable ceiling increases, and coverage expansion. Given a choice between fiscal instruments, it would certainly be rational on the part of social insurance advocates to choose the finance scheme of "least resistance."[1] Ideally, this would be the finance scheme that dispersed the cost burden of additional expenditures most broadly and, in so doing, reduced the incentive of taxpayer groups to invest resources in lobbying against program expansion.

At first glance, neither compulsory coverage expansion nor taxable ceiling increases seem to fit the bill since in both cases they would affect a minority of workers. To the contrary, however, because of the peculiar nature of a pay-as-you-go system, and the quite high rates of return payable in its early years, coverage expansion was a particularly attractive means of financing billions of dollars of additional expenditures. In fact, coverage expansion was the first finance scheme whose use was actively advocated by Social Security bureaucrats and other expansionists.

By the mid-1950's, coverage had been expanded to nine out of ten workers, and Congress turned to tax rate increases. Why, then, were tax rate increases employed exclusively through 1966 rather than ceiling increases? Then, how can we explain the recent emphasis on real ceiling increases? There are two possible explanations for these phenomena, both of which would have predicted the use of real ceiling increases after 1965.

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[1]For a discussion of fiscal illusion and its impact on budgetary decisions, see James M. Buchanan, Public Finance in Democratic Process (Chapel Hill, N.C.: University of North Carolina Press, 1967), pp. 126-143.

Recognizing that real ceiling increases transfer the burden of additional expenditures to workers above the previously existing ceiling, it would be reasonable to predict that the use of real ceiling increases would have been pursued after coverage had been expanded to higher paid occupations, with tax rate increases employed meanwhile. The reason for this is that unlike a tax rate increase which broadly disperses the cost burden, real ceiling increases concentrate the costs on a clearly defined subset of upper income worker-voters, thus raising their incentive to invest resources in lobbying against them.

In fact, despite the fact that nine out of ten workers were covered during the 1950's, it was not until 1965 that compulsory coverage was extended to most higher paid workers, in particular, self-employed professionals.[1] Had real ceiling increases been employed first, thus making the redistributive nature of the program clear, it is unlikely that coverage could have been extended to self-employed professionals as early as the 1960's. And, moreover, from the point of view of income redistributionists the ability to transfer income among taxpayers made possible by an expansion of coverage to higher paid workers would surely have exceeded that which was available by simply increasing the ceiling for currently covered workers.

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[1]Coverage was extended in 1954 to the self-employed except professional doctors, lawyers, dentists and other medical groups. In 1956, compulsory coverage was extended to the professional self-employed except doctors. Doctors were not covered until 1965. See Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, p. 15. Moreover, in 1965, average annual earnings for covered wage and salary workers were $4,128, or two-thirds the average annual earnings for covered self-employed. See Ibid., p. 66.

Once covered, these workers provided an attractive, and exploitable, source of new revenues since covered workers earning more than the taxable ceiling only constituted twenty-five percent of all taxpayers.[1] Large taxable ceiling increases were demanded not only by income redistributionists who sought to redistribute the tax burden among worker-taxpayers, but also by representatives of such beneficiary groups as the elderly. Ceiling increases would bestow windfall gains to current beneficiaries, as well as a tax break for the near-elderly who, as a group, typically had earnings less than the ceiling.

But, how quickly could this new source of revenues be tapped? Intuitively we would predict that real ceiling increases would have been employed as soon as the number of gainers exceeded the number of losers. At first glance, however, it would seem that the number of gainers--including all beneficiaries of program expansion and most workers below the ceiling--have always exceeded the number of losers. On the other hand, once one recognizes the relatively small tax savings for taxpayers under the ceiling and therefore the relatively low incentive for them to actively lobby for ceiling increases, we would predict that ceiling increases would have emerged soon after the number of direct beneficiaries exceeded the number of persons above the taxable ceiling. In fact, real ceiling increases were first employed in 1967, the second year in the history of the program in which this was the case.[2]

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[1] Ibid., p. 68.

[2] For the figures employed here, see Ibid., p. 72; and Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, p. 46.

In conjunction with the tactic first employed in 1966 of tying across-the-board benefit increases to pending, non-germane legislation, the use of a real ceiling increase in 1967 was yet another development of the 1960's that foreshadowed future developments.

1960-1968: A Summary

In all, a Democratic Congress during the Kennedy-Johnson years put few effective constraints on the expansion condoned by Social Security officials and lobbyists representing the growing number of Social Security beneficiaries. This was hardly surprising given the growing complexity of the program and the fact that by 1968, beneficiaries numbered 24 million, or 20 percent of the voting age population.[1]

The net effect of the many changes enacted between 1960-1968 was a 87 percent increase in real expenditures out of the OASDI trust funds alone.[2] From the point of view of the individual taxpayer the $19 billion increase in expenditures over the period were reflected in a 100 percent increase in the real maximum tax payment and, as shown in Table 35, a significant increase in the complexity of the program. Between 1960-1968 alone, age requirements were reduced for male retirees, disabled workers, widows, and widowers while the age at which childrens' benefits were still payable was increased. Also, benefits were made payable--at no additional cost--to divorced wives, disabled widow(er)s, and to the survivors, dependents, and retired workers in

[1]U.S. Bureau of Census, Statistical History of the U.S., p. 10; and Social Security Administration, Social Security Bulletin, p. 60.

[2]Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, pp. 61-63.

TABLE 35

BENEFICIARIES OF THE OASDHI PROGRAM AS OF 1968

Beneficiary	Max. Mo. Benefit as % of P.I.A.[a]	Age payable
	INSURED WORKER	
Retired Worker	100%	62[b]
Disabled Worker	100%	--[c]
	DEPENDENTS OF RETIRED OR DISABLED WORKER	
Wife	50%	62[b]
Child	50%	under 21
Disabled Child	50%	18
Husband	50%	62[b]
Divorced Wife	50%	62[b]
	SURVIVORS	
Widowed Mother	75%	--[c]
Widow	82.5%	60
Disabled Widow	82.5%	50-59[d]
Child	75%	under 21
Disabled Child	75%	18
Parent	82.5%	62
Widower	82.5%	62
Disabled Widower	100%	50-61[e]
	TRANSITIONALLY INSURED[f]	
Worker	$ 40	72
Wife	$ 20	72
Widow	$ 40	72

TABLE 35--Continued

Beneficiary	Max. Mo. Benefit as % of P.I.A.[a]	Age payable
	SPECIAL MONTHLY BENEFITS[g]	
Individual	$ 35	72
Couple	$ 52.50	72

SOURCE: U.S. Department of Health, Education, and Welfare, Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), pp. 11-12, 19-21.

[a]The primary insurance amount (P.I.A.), upon which benefits are based, is functionally related to the worker's average monthly earnings. Benefits may be actuarially reduced for early benefit payment.

[b]Benefits actuarially reduced if received before age 65.

[c]No age requirement stipulated.

[d]Benefits actuarially reduced if received before age 60.

[e]Benefits actuarially reduced if received before age 62.

[f]For persons who do not qualify for OASDHI benefits on the basis of their covered earnings history, but do meet special minimum coverage requirements.

[g]For persons who do not qualify for OASDHI benefits or transitional insured benefits on the basis of their covered earnings history.

families in which the worker had minimal to no covered earnings. Finally, benefit rates were increased for widow(er)s, parents, and children of retired workers. By 1968, there were twenty different beneficiary categories under the OASDI program with an array of seemingly arbitrary benefit and eligibility criteria.

The Nixon Years: 1968-1974

The momentum gained and the trends begun in the 1950's and 1960's were unabetted during the Nixon years. Indeed, the many amendments enacted during these years, including particularly rapid benefit increases, attested to not only the strength of an alliance comprised of high demand special interest groups and Social Security bureaucrats, but also the political savvy of Representative Wilbur Mills (D.-Ark.), Chairman of the House Ways and Means Committee, and Senator Russell Long (D.-La.), Chairman of the Senate Finance Committee. Against repeated threats of veto by the Administration, amendments were enacted between 1968-1974 which increased real OASDHI expenditures by $30 billion, increased the real maximum individual tax payment 60 percent, and increased real benefit levels by 25 percent.[1]

Most effective in gaining passage of these changes was the tactic first employed by Senator Prouty in 1966. Just as had been the case then, in 1969, 1971, 1972, and 1973, politically appealing across-the-board benefit increases were tied to the enactment of pending, non-germane legislation for which passage was all but certain. The

[1]See Tables 31, 32, and 33.

early 1970's evidenced most clearly the inability of fiscal conservatives to constrain the demands of more than 25 million beneficiaries, and the ability of Congress to gain political favor by transferring income among the growing number of beneficiaries and from workers to beneficiaries.

Aside from rapid increases in benefits, particularly minimum benefits payable, and the reliance on real ceiling increases in lieu of large tax rate increases, an important outgrowth of the Nixon years was the implementation in 1972 of a cost-of-living indexing provision in the Social Security program. The "technically" flawed inflation adjustment mechanism was destined to become a contributing factor in the impending "fiscal crisis." Moreover, 1972 marked the culmination of a forty year struggle over the appropriate role of the federal government in poverty relief programs. In that year, each of the state-administered assistance programs were collapsed into a single federal assistance program, Supplementary Security Income (SSI).

Amendments to the 1969 Tax Reform Act

President Nixon proposed major reform of the welfare system as early as August of 1969. At that time, he advocated the replacement of Aid to Families with Dependent Children (AFDC), the largest and most costly of the four public assistance titles, with a Family Assistance Plan (FAP). Unlike the prevailing system in which benefits were limited to families with dependent children, the FAP would have provided a minimum welfare payment of $1,600 ($2,349) per year to all poor families with the stipulation that mothers and fathers accept training or employment. These recommendations were incorporated into HR 14173 and introduced into Congress during October by Representative John Brynes (R.-Wisc.).[1]

A month later, President Nixon proposed an automatic cost-of-living indexing provision for Social Security benefits and the taxable ceiling along with a 10 percent increase in Social Security benefits (HR 14080). Hearings began on the proposed changes in both welfare and OASDI during October; but because of the controversial nature of the proposals, action appeared unlikely before the close of the session.

On December 5, the House Ways and Means Committee reported a clean bill (HR 15095) that did not address either of the President's major recommendations: welfare reform or Social Security indexing. Instead, the bill included an across-the-board increase in Social Security benefits of 15 percent, effective January 1, 1970. This 5 percent real benefit increase and other changes were to be financed under the currently scheduled tax rates and taxable ceiling.[2] Since the program was not entirely on a pay-as-you-go basis, there remained buffer reserves that could be drawn down indiscriminately. As such, these reserves provided a particularly attractive means of financing additional

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[1]See Congressional Quarterly Almanac, Vol. XXV, pp. 814-840; American Enterprise Institute, The Pending Social Security Amendments of 1970, Legislative Analysis No. 14 (Washington, D.C.: American Enterprise Institute, October 7, 1970); and American Enterprise Institute, Welfare Reform Proposals, Legislative Analysis No. 4; for detailed examinations of the legislative developments in 1969-1970.

[2]American Enterprise Institute, The Pending Social Security Amendments of 1970, p. 1.

expenditures, since the distribution of tax costs was so uncertain.

To make certain the 15 percent benefit hike would be passed before the end of the year, the Senate accepted an amendment offered by Senator Long, identical to HR 15095, which was attached to Nixon's tax reform bill (HR 13270). Nixon threatened to veto the tax reform bill because of the large benefit increases, but signed the package into law on December 30, 1969.[1]

The Cost-of-Living Indexing Issue

In response to the demands of the elderly, and in an effort to routinize what had become an ad hoc procedure in Congress, President Nixon proposed, in 1969, automatic cost-of-living increases in benefits and the taxable ceiling. The indexing proposal was endorsed, in his words, to "depoliticize, to a certain extent, the Social Security system and give a greater stability to what has become a cornerstone of our society's social insurance system."[2] Creed Black, Assistant Secretary of HEW, suggested that the enactment of the President's recommendations would lead to a "substitution of economic determinants for biennial politics" in setting benefit increases.[3]

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[1] Congressional Quarterly Almanac, Vol. XXV, p. 840.

[2] American Enterprise Institute, Social Security Amendments, Reprint of Legislative Analysis No. 14, p. 21.

[3] Ibid., p. 22. The proposal for indexing Social Security recommended that if prices increased at least 3% over the course of the year, an equivalent increase in Social Security benefits was to be reflected in checks mailed out the following year. The taxable ceiling, beginning with a base of $9,000, was to be indexed to increases in average earnings. However, there was no symmetrical provision for benefit reductions if prices fell, and no provision for tax rate adjustments. For

Advocates of automatic adjustments emphasized that although Congressional benefit increases had tended to keep pace with changes in the price level, there were lags in adjustments that generated losses for the elderly who were living off low "fixed incomes." An annual adjustment would hasten a restoration of their purchasing power. Moreover, indexing would not prohibit Congressional action. It was simply a method of assuring annual cost-of-living adjustments in (the unlikely) case they had not been legislated.

Others advocated the benefit and taxable ceiling indexing provision since it would have guaranteed that persons earning above the taxable ceiling were not systematically benefitted as inflation eroded the real ceiling. Certain key supporters of indexing, including most notably organized labor, however, advocated relatively large increases in the taxable ceiling before instituting the automatic adjustment.

No action was taken in 1969 on the President's proposal, and in 1970, the 1970 Amendments (HR 17750) were reported out of the Ways and Means Committee without provision for automatic adjustments.[1] In fact, it was not until Jackson Betts (R.-Ohio) moved to recommit the bill to the Committee for inclusion of such a provision that the House Ways and Means Committee took positive action. Chairman Wilbur

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further discussion on the pro's and con's of indexing, see Ibid.; 1971 Advisory Council on Social Security, Reports on Old-Age, Survivors, and Disability Insurance, and Medicare Programs (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1971); and American Enterprise Institute, Social Security Amendments, pp. 21-26.

[1] Congressional Quarterly Weekly Report (1971), p. 1367.

Mills had opposed automatic benefit increases on the grounds that Congressional action made the provision unnecessary.

Opponents of the automatic adjustments viewed them as a challenge to Congressional prerogatives, or Congressional discretion. Indeed, Social Security benefit increases were becoming particularly popular election issues at a time when one out of eight Americans were benefit recipients, the vast majority of whom were of voting age.[1]

Others opposed automatic cost-of-living adjustments because of their likely impact on inflation. First, as recipients' incomes became immunized against inflation, there might result less pressure to constrain and control inflationary policies. Second, it was feared that Social Security indexing might have had even broader ramifications by leading to demands for automatic adjustments of welfare benefits, negotiated wage agreements, etc.[2]

For those concerned with the rapid acceleration of Social Security expenditures, a major concern over indexation should have been its likely impact on legislated benefit increases. As the major opposition to cost-of-living adjustments centered on the undesirability, from the Congressmen's point of view, of taking the credit for benefit hikes away from elected representatives in election years, one could

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[1]In the words of Wilbur Mills, "Is the Congress going to get any credit for future adjustments of benefits, or are we going to . . . let the Secretary of HEW get all that credit?" See Congressional Record (May 21, 1970), H4669.

[2]See the dissenting opinion of Gabriel Hauge in the 1971 Advisory Council on Social Security, Reports on OASDI and Medicare, p. 104.

have predicted that the Congress would have maintained its discretion and gained political favor by enacting legislated benefit increases before the automatic increases took place in January, or by enacting larger than cost-of-living benefit increases. Indeed, what had been the case historically was that larger than cost-of-living benefit increases legislated one year to offset some future inflation, were met the following year by cries of an "erosion of purchasing power for persons on fixed incomes" as prices began to rise. The stage, being set for additional benefit increases, naturally led to an increase in real benefits over time. Although indexing would have made this process more apparent, it could not have eliminated this course of events.[1]

Finally, the "technical" problem with the proposed automatic adjustment, known as "double-indexing," was apparently not an issue.[2] Double-indexing is a (correctable) problem whereby inflation not only leads to higher benefits for recipients through its impact on automatic adjustments in benefits but also increases expected benefits for future retirees through its impact on earnings. More specifically, since the

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[1] An indexing provision for benefit levels, the earnings test, and the taxable ceiling was enacted in 1972; and as of 1977 this had not yet occurred because of concern over the financial soundness of the system which surfaced during the 1973-1975 period.

[2] For a discussion of the technical problem of "double-indexing," see Colin D. Campbell, Over-Indexed Benefits: The Decoupling Proposals for Social Security, Domestic Affairs Study No. 46 (Washington, D.C.: American Enterprise Institute, May, 1976), pp. 5-6; "Propping Up Social Security," Business Week, July 19, 1976, p. 36; and Alicia H. Munnell, The Future of Social Security, Brookings Studies in Social Economics (Washington, D.C.: The Brookings Institution, 1977), pp. 32-40.

covered worker's average monthly earnings, a non-indexed nominal value upon which benefits are calculated, can be expected to rise during periods of inflation, the system over-responds to inflation and causes inequities by producing erratic rates of return. As a result, two workers with exactly the same real average earnings need not get the same benefit upon retirement. If one worker simply earns his income during periods of more rapid inflation, he would be entitled to a higher benefit. As an outgrowth of double-indexing, and given a downward weighted benefit formula, a person with low average earnings, earned during periods of rapid inflation, can actually get a higher monthly benefit from Social Security upon retirement than his income prior to retirement. Like any other amendment to the Social Security Act, it must certainly have been the subject of a great deal of study at the Social Security Administration before its recommendation and enactment. Indeed, it would be difficult to believe that the indexing proposal and its likely impact on rates of return escaped careful scrutiny.[1]

The Welfare Reform Issue and OASDHI

Whereas Nixon's indexing proposal may be considered a response to the demands of OASDHI beneficiary groups, his proposal for reform of the welfare system may be better considered a response to the demands of taxpayers in general. In fact, rapid increases in the cost of the various public assistance programs during the 1960's elevated

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[1]It was not, however, until 1975 that the problem of double-indexing was admitted as a serious one by the Social Security officials, and as of mid-1977, nothing had been done to alleviate it. This issue is discussed more fully in Chapter VI.

welfare reform to an important and controversial political issue, and contributed toward an increasing reliance on the OASDHI program for income redistribution.

As shown in Table 36, thirty years had elapsed before real expenditures on public assistance reached $10 billion. In the following 5 years alone, however, real expenditures doubled; and 3 years later, reached $30 billion.

In spite of, and in part because of, the federal government's increasing role in financing these programs, state expenditures showed similarly rapid growth during the 1960's. Between 1960-1970, real state and local expenditures increased more than 200 percent, reaching $9.5 billion in 1970.[1] With each state desiring to transfer part of its tax costs to others, a natural outgrowth of these trends in state welfare costs was the emergence of bipartisan support for increased federal participation, if not a complete federalization of the programs.

Along similar lines, Table 37 provides insight into why there arose during the 1960's and early 1970's bipartisan demands for increasing reliance on the OASDHI program for income redistribution. Increases in real OASDHI benefit levels, particularly the minimum benefit payable, and reductions in eligibility requirements provided direct means through which states could disperse tax costs through a national payroll tax. While these institutional changes were certainly

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[1]See "Social Welfare Expenditures, Fiscal Year 1976," Social Security Bulletin, Vol. XL, No. 1, pp. 5-7; and Social and Rehabilitative Service, Trend Report: Graphic Presentation of Public Assistance and Related Data (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1969), p. 11.

TABLE 36

TRENDS IN PUBLIC ASSISTANCE EXPENDITURES: FEDERAL FUNDS RELATIVE TO STATE AND LOCAL FUNDS, 1936-1976[a]
(in Millions)

Fiscal year	Current dollars		Constant dollars[b]		Percent federal funds
	Total expen- ditures	State & local funds	Total expen- ditures	State & local funds	
1936	$ 349.8	$ 329.6	$1,361.0	$1,282.4	6%
1940	1,122.6	843.2	4,301.1	3,230.6	25%
1950	2,490.2	1,393.0	5,558.4	3,109.3	45%
1960	4,041.7	1,984.2	7,348.5	3,607.6	51%
1965	5,874.9	2,689.5	10,025.4	4,589.5	55%
1970	14,433.5	6,839.2	20,032.5	9,485.7	53%
1971	18,075.0	8,271.7	24,035.9	10,999.6	55%
1972	21,895.0	9,786.9	28,178.8	12,595.7	56%
1973	24,002.6	10,630.3	29,058.8	12,869.9	56%
1974	23,827.4	10,520.2	26,012.4	11,484.9	56%
1975	26,758.2	12,211.5	26,758.2	12,211.5	55%
1976	31,171.5	14,203.5	29,687.1	13,527.1	55%

SOURCES: U.S. Department of Health, Education, and Welfare, Social Security Administration, "Social Welfare Expenditures, 1976," Social Security Bulletin, Vol. XL, No. 1 (Washington, D.C.: Government Printing Office, 1976), pp. 5-7.

U.S. Department of Health, Education and Welfare, Social and Rehabilitation Service, Trend Report: Graphic Presentation of Public Assistance and Related Data, 1966 (Washington, D.C.: Department of Health, Education, and Welfare, 1967), p. 11.

[a]Expenditures on Public Assistance denotes expenditures under the Social Security Act on means-tested welfare programs which include Old-Age Assistance; Aid to the Blind; Aid to Families with Dependent Children; Medical Assistance for the Aged; Aid to the Permanently and Totally Disabled; and General Assistance, the latter being a completely state financed program.

[b]1975 dollars.

TABLE 37

TRENDS IN SELECTED PUBLIC ASSISTANCE PROGRAMS: RECIPIENTS AND MONEY PAYMENTS 1936-1973[a]

Program	1936	1940	1950	1960	1965	1970	1971	1972[c]	1973[c]
RECIPIENTS (in thous.):									
Total	1,699	3,365.4	5,185.3	5,854.0	7,125.1	12,757	13,823.3	14,656.4	13,991.9
OAA	1,108	2,070.0	2,786.0	2,305.0	2,087.0	2,082	2,024.0	2,034.0	1,831.0
AFDC	546	1,222.0	2,233.0	3,073.0	4,396.0	9,659	10,651.0	11,011.0	10,857.0
AB	45.2	73.4	97.5	107.0	85.1	81	80.3	81.4	77.9
APTD	---	---	68.8	369.0	557.0	935	1,068.0	1,530.0	1,226.0
PAYMENTS (in mill.):[b]									
Total	$ 81.4	$ 594.4	$2,040.3	$2,885.7	$3,651.4	$6,866.4	$8,750.5	$10,285.5	$10,548.1
OAA	52.9	449.9	1,437.9	1,614.3	1,606.1	1,823.1	1,898.3	1,915.1	1,724.6
AFDC	22.8	123.3	520.3	961.7	1,573.7	4,065.4	5,656.4	6,886.7	7,128.5
AB	5.7	21.2	51.0	84.6	86.6	95.0	100.1	109.4	104.8
APTD	---	---	31.1	225.1	385.0	882.9	1,095.7	1,374.3	1,590.2

TABLE 37--*Continued*

SOURCES: U.S. Department of Health, Education, and Welfare, Social and Rehabilitation Service, *Public Assistance Statistics: August, 1973* (Washington, D.C.: Department of Health, Education, and Welfare), Table 1.

Social and Rehabilitation Service, *Trend Report: 1971*, p. 9.

[a]Expenditures on money payments only for the four major means-tested programs under Social Security: Old-Age Assistance (OAA); Aid to Families with Dependent Children (AFDC); Aid to the Permanently and Totally Disabled (APTD); and Aid to the Blind (AB). Not included in these figures are expenditures on Medical Assistance for the Aged, General Assistance, administration and capital outlay.

[b]Current dollars.

[c]Money payments for 1972 and 1973 are estimates based on monthly data.

inconsistent with the objectives of an earnings related insurance program, they were most consistent with the objective of redistributing tax costs. Indeed, in contrast to the rapid increases in the cost of the AFDC and APTD programs, real expenditures on old-age assistance actually fell after 1950.

Amendments to the 1971 Debt Ceiling Extension Bill

The bill (HR 17550) which contained President Nixon's proposals for indexing and welfare reform died in Congress during 1970 and was reintroduced in 1971 by Representative Mills (HR 1).[1] In addition to indexing, the bill contained provisions for a 10 percent increase in Social Security benefits, various liberalizations of the Social Security program, as well as the Administration's Family Assistance Plan. The controversial nature of the bill made action appear unlikely even in 1971.

During the period of time in which the House Ways and Means Committee had been studying HR 1, the Committee was also working on a bill to extend the federal debt ceiling (HR 4690), which the House went on to pass during March, 1971. Not one to miss an opportunity to increase Social Security benefits, Senate Finance Committee Chairman Russell Long offered an amendment to the debt ceiling extension bill to increase Social Security benefits by 10 percent.

[1]See American Enterprise Institute, The Pending Social Security Amendments of 1970, Legislative Analysis No. 14; and Social Security Amendments of 1970, Legislative Analysis No. 5 (May 19, 1971); and Congressional Quarterly Weekly Report (1971), p. 1367.

As enacted, HR 4690 increased the temporary national debt ceiling, increased Social Security benefits by 10 percent (effective January 1, 1971), and increased special age 72 benefits by 5 percent. The Social Security revisions were to be financed by an increase in the nominal taxable ceiling of more than 15 percent (effective January 1, 1972). Tax rate increases were postponed until 1976.[1]

Hearings were resumed in the House Ways and Means Committee on the Social Security Amendments of 1970 (HR 1) and on June 22, 1971, the 687 page bill was passed by the House.[2] As approved by the House, HR 1 included a comprehensive array of changes in OASDI, Medicare, Medicaid, and public assistance. Aside from an additional 5 percent increase in Social Security benefits and a 13 percent increase in the taxable ceiling from $9,000 ($10,372) to $10,200 ($11,583), the bill included Social Security indexing, special minimum benefits for persons with long periods of employment and low average earnings, higher widows' benefits (from 82.5 percent to 100 percent of husband's benefit), and a liberalized retirement test. The bill also extended Medicare benefits to disabled persons and increased Medicare benefits in general. With regard to the public assistance titles of the Act, the House bill unified all four federal-state programs into a single uniform federal program with 100 percent federal financing.

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[1]See Congressional Quarterly Almanac, Vol. XXVII, pp. 421-425. Between January, 1970, the time of the last benefit increase (15 percent) and January, 1971, prices had only increased 5.9 percent.

[2]For the details of the bill, see Congressional Quarterly Weekly Report (1971), pp. 1367, 1449, and Congressional Quarterly Almanac, Vol. XXVII, pp. 519-526.

The most controversy had been generated by the inclusion of two plans to alleviate poverty within poor families: Opportunities for Families, a program for employable parents in poor families; and the Family Assistance Plan, for unemployable parents of poor families. No recipients under age sixty-five would have been eligible for benefits without either accepting rehabilitation or working. The employable poor would have been compelled to take jobs in order to be eligible for benefits ranging from \$800-\$3,600 (\$1,064-\$4,787) per year, depending upon family size. These benefits were to be gradually decreased as the family's earnings increased.

The major purpose of HR 1 as stated by a 386 page report by the House Ways and Means Committee was to effect a change in the welfare system by encouraging employable adults to seek employment. As illustrated by the following figures, a prime motivation for the proposed legislation was the rapid increase in both total expenditures and the number of AFDC recipients. Whereas in 1960, there were 3 million AFDC recipients, in the following decade, this figure had tripled to 10.8 million recipients. Moreover, whereas the program had taken twenty-five years, through 1960, to incur total expenditures of \$1 billion, in each of the following years, expenditures exceeded \$1 billion, and in 1971 alone, expenditures exceeded \$6.2 billion.[1]

Opposition to the welfare provisions of the bill came from an unusual array of strong conservatives and strong liberals. Some conservatives opposed the introduction of anything resembling a guaranteed

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[1]See Table 37.

annual income, due to concomitant impacts on work incentives and the likelihood that the income level would become subject to increasing political demands. Liberals, on the other hand, objected to the work provisions for parents and doubted the wages paid would be "adequate."[1]

Proponents simply relied on the current welfare mess as reason enough for change. The Secretary of Labor, James Hodgson, and the Secretary of HEW, Elliot Richardson, both endorsed the House bill. To fuel House passage of the bill, President Nixon had sent a letter to the House Speaker, Carl Albert (D.-Okla.), in which he called HR 1 "the most important social legislation in 35 years." Should the bill be defeated, he said, "we will be committed to the perpetuation of a system which is an obsolete and demoralizing failure."[2]

As the 1971 session of Congress closed, action on HR 1 was still pending in the Senate Finance Committee. The need for quick action had been diminished, of course, when the 10 percent Social Security benefit hike was passed with the debt ceiling bill in early 1971.

Amendments to the 1972 Debt Ceiling Extension Bill: A Turning Point

1972 marked the third year out of the previous four in which across-the-board benefit increases were passed. Also, it was the year in which the comprehensive Social Security-welfare reform bill (HR 1) made it out of the Senate Finance Committee with a 10 percent benefit

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[1]Congressional Quarterly Almanac, Vol. XXVII, p. 521.

[2]Ibid., p. 525.

hike, got bogged down in bitter Senate debates over "Workfare" provisions, then subsequently died in Congress. During this same period of time, Congress went on to pass, in June, a 20 percent increase in Social Security benefits (effective September 1, 1972) by attaching it to a debt ceiling extension bill. In many ways, the amendments enacted marked a "turning point in the capacity of the system."[1]

An amended version of HR 1 had been tentatively approved by the Senate Finance Committee on June 13, 1972, 2-1/2 years after President Nixon had made his proposals and after eleven months of Committee dispute.[2] Whereas the Administration supported the House bill which provided guaranteed incomes to all working-poor families, the Senate Finance Committee created a "Workfare" plan that would have removed 1.2 million persons from the welfare rolls and provided them with guaranteed jobs. In effect, the Committee concluded that welfare would no longer be provided to families with able-bodied fathers, or mothers of children over six. Instead, a new government agency, the Work Administration, would have been established to guarantee jobs for employables. Others would have continued to be taken care of through federal-state assistance grants.

Similar to the House bill, the Finance Committee tentatively approved a 10 percent increase in Social Security benefits, an increase

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[1]Statement by Representative John W. Byrnes (R.-Wisc.) cited by <u>Congressional Quarterly Almanac</u>, Vol. XXVIII, p. 403.

[2]For a detailed discussion of the Welfare-Social Security bill as it emerged from the House and the Senate Finance Committee, see <u>Congressional Quarterly Weekly Report</u> (June 17, 1972), pp. 1495-1499.

in the taxable ceiling and tax rates, and for the future, indexing of Social Security benefits and the taxable ceiling. In addition, they recommended expanding the OASDI and Medicare programs.

Aside from the welfare proposals, the appropriate size of the Social Security benefit increase was the subject of debate. In particular, were 10 percent increases large enough? A motion to provide 15 percent increases was rejected by a tie-vote so the 10 percent provision prevailed; yet Abraham Ribicoff (D.-Conn.), Fred Harris (D.-Okla.), and Gaylord Nelson (D.-Wisc.) all endorsed 20 percent increases in Social Security benefits. The 20 percent hike which would have constituted a 14 percent real increase was favored by Mills, Long and many Senators on the floor.[1]

During this same period of time, the Ways and Means Committee was preparing a bill to extend the national debt ceiling beyond the date it was scheduled to be terminated--midnight, June 30.[2] As a result, when on June 22, President Nixon announced he would not compromise with Senate liberals on "Workfare," the Senate accepted an amendment by Frank Church (D.-Id.) to attach to the debt ceiling bill a 20 percent Social Security benefit increase, indexing, and an increase in scheduled tax rates and the taxable ceiling.

The House refused to accept the very large benefit increase, and on the afternoon of June 30 sent the debt ceiling bill to conference.

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[1]Ibid. (June 17, 1972), p. 1495; and (July 8, 1972), pp. 1702-3.

[2]Congressional Quarterly Weekly Report (1972), p. 1630; and Congressional Quarterly Almanac, Vol. XXVIII, pp. 399-403.

Wilbur Mills told members of the House heroically that if they adopted the 20 percent benefit increase, "I can assure the membership of this House that we will over the forthcoming 75 year period, take in each year more money than we will be paying out."[1] In marked contrast, Representative Byrnes (R.-Wisc.) remarked,

> If you insist on voting a 20 percent Social Security benefit increase without any study by the Ways and Means Committee of the soundness of the fundamental concepts involved in the financing provided, it may well mark a turning point in the capacity of the Social Security system to respond with equity to the needs of our older people.[2]

The conference committee accepted the 20 percent benefit hike, and late in the evening of June 30, the House accepted the conference report.

On the morning of July 1, President Nixon signed into law the debt ceiling extension bill (HR 15390, PL 92-336) and with it a 20 percent across-the-board benefit increase, an increase in the taxable ceiling, a reduction in scheduled tax rates, and an automatic cost-of-living indexing provision. Upon signing the bill, Nixon expressed his displeasure with the benefit increase which, he said, "threatened to escalate inflation." Further, he said, he planned to offset this expansion through cuts elsewhere in the federal budget.[3] It was clear to most observers that had it not been the case that the debt ceiling extension bill was scheduled to revert to $400 billion, more than $25

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[1] Congressional Quarterly Almanac, Vol. XXVIII, p. 402.

[2] Ibid., pp. 402-403.

[3] Congressional Quarterly Weekly Report (1972), p. 1752. This constituted a 14 percent increase in real benefit levels since the last benefit increase a year earlier.

billion less than the amount of federal debt outstanding, Nixon would have vetoed the 20 percent benefit increase.[1]

Impact of the 1971 Advisory Council

Without some further comment, the 14 percent increase in real benefits alongside a reduction in scheduled tax rates would appear to indicate that Congress acted with gross fiscal irresponsibility. Since 1968, alone, real benefits had already been increased 37 percent.[2] As it has turned out, the system is faced with serious long range deficits that are partly due to the 1972 amendments, but at the time these amendments were enacted, there had been little evidence presented to Congress to support this fear.

Although Social Security benefit hikes had become remarkable election issues, there was yet another rationale behind both the 20 percent increase and Representative Mills' heroic statement. In 1971, the Advisory Council on Social Security actually reported that the Social Security program was over-financed and would eventually have accumulated reserves near $1 trillion (by the year 2025). They recommended, therefore, financing the program so that trust fund reserves would be kept down to approximately one year's expenditures in order to

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[1] Congressional Quarterly Almanac, Vol. XXVIII, p. 399.

[2] See Table 32 for the historical trend in real benefit levels. This figure grossly understates the real increase in benefits as calculated on the basis of increases in total Social Security benefit expenditures. This is because the last figure would include the impact of program expansion through liberalized eligibility requirements, new benefit formulas, growing numbers of beneficiaries, etc.

alleviate this "unnecessary and undesirable" accumulation.[1]

In line with this recommendation, a subcommittee of actuaries and economists to the Advisory Council recommended abandoning existing methods of estimating long range costs and setting future tax rates. The method of estimation, used by Social Security actuaries, employed a "level-wage" assumption that consistently generated unexpected surpluses in the funds.[2] Indeed, the assumption that the most recent average annual taxable wage would continue indefinitely was nearly guaranteed to produce surpluses since wages, in fact, tended to rise over time. In order to put the system more nearly on a pay-as-you-go basis, both in the short and long term, the subcommittee recommended more reliable predictions be based on "reasonable assumptions concerning the future growth in average covered wages;" and the Advisory Council recommended a declining tax rate schedule.[3]

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[1]See 1971 Advisory Council on Social Security, Reports on OASDI and Medicare.

[2]The Subcommittee on Cost Estimates and Financial Policy of the 1971 Advisory Council on Social Security included Otto Eckstein, Arnold Harberger, Murray Latimer, Wendell Milliman, and Nancy Teeters. For their statement of recommendations, see Ibid., pp. 124-133.

[3]Ibid., pp. 91-92, and 124-127. The Advisory Council also recommended benefit increases, particularly for minimum benefits, to insure that no recipient was below the poverty line; larger widow(er) benefits; liberalized eligibility requirements for disability insurance; a liberalized earnings test; extended Medicare coverage to include the disabled; more services to be covered by Medicare.

To finance the changes and to put the system on a pay-as-you-go basis, they recommended increasing the taxable ceiling and reducing future tax rates. That is, they proposed a tax rate schedule that actually declined through the twenty-first century, then rose rapidly. They said, a pay-as-you-go system allowed the postponement "well into the next century, any increases in the contribution rates for a cash benefit program with benefits adjusted to price changes." Ibid., p. 90.

These recommendations were accepted in the 1972 amendments, and it was apparently in response to these changes that Mills guaranteed actuarial balance in the future. The 20 percent benefit increase could be justified, partly, as serving to eliminate some of the "unexpected" surpluses in the interim.[1]

Little did Representative Mills and the subcommittee realize that one of the most severe economic recessions was ahead. While the old level-wage assumption had been designed to produce sufficient revenues in the long range even in the case of economic recessions, new estimating techniques were not. Add this mistake to the introduction of double-indexing and there emerges, in part, an explanation of the current "crisis" in Social Security financing. In hindsight, it appears evident that the words of Representative Byrnes should have been heeded.

The Amendments of 1972

As Senate liberals undoubtedly knew, early passage of the 20 percent benefit increase in June made positive action on comprehensive welfare reform less likely. In fact, as HR 1 was passed by the Senate on October 6, the bill increased Social Security, Medicare, and Medicaid benefits, and rejected effectively any major welfare reform.

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[1]For more discussion of the impact of the 1971 Advisory Council on the 1972 Amendments, see "Propping Up Social Security," Business Week, July 19, 1976, pp. 34-43; and Robert Kaplan, Financial Crisis in the Social Security System. What had been done with these "unexpected" surpluses? Since the system is now intended to be on a pay-as-you-go basis, Congress responded by postponing tax rate increases and by increasing current benefits--the level wage assumption produced windfall gains for current beneficiaries.

As it had become evident that no single welfare reform plan could muster consent, the Senate passed an amendment to try three alternative plans--all on a trial basis. The three plans were: (1) Nixon's Family Assistance Plan as incorporated in the House bill; (2) the Senate Finance Committee's "Workfare" plan, endorsed by Senate conservatives led by Senator Long; and (3) Senator Ribicoff's (D.-Conn.) alternative to what he called "slavefare" which would have guaranteed employment at a significantly higher minimum income. The motion to adopt all three plans on a trial basis was supported by all the Southern Democrats in the Senate and most Republicans.[1]

As such, the House and Senate versions of HR 1 were widely different and in the conference report, welfare reform was deleted entirely. As cleared by the Congress on October 17, 1972, the bill (HR 1, PL 92-603) contained many revisions of the Social Security Act.[2] Changes in OASDHI included:

(1) An increase in the taxable ceiling from $9,000 to $10,800 in 1973, and to $12,000 in 1974.[3]

(2) An increase in the schedule of tax rates.

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[1]Congressional Quarterly Weekly Report (October 7, 1972), pp. 2628-2629; and (October 28, 1972), p. 2804.

[2]See Congressional Quarterly Almanac, Vol. XXVIII, pp. 899-914.

[3]In 1975 prices, this constituted an increase from $11,688 in 1972 to $13,100 in 1974, increasing the maximum tax payment 26 percent, from $1,215 to $1,533.

Changes in OASDI included:

(1) An increase in widow(er)s' benefits from 82.5 percent to 100 percent of the spouse's monthly benefit.

(2) The institution of a special minimum benefit for persons who had worked for many years in covered employment at low wages.

(3) A benefit increment of 1 percent per year for persons who continued to work beyond the age of sixty-five.[1]

Changes in Hospital Insurance included:

(1) The deletion of the co-payment terms for home health services.

(2) Liberalized eligibility.

Finally, changes in Public Assistance included:

(1) Effective January 1, 1974, the consolidation of all state-federal public assistance programs into a single federally financed and administered program, Supplementary Security Income, with a minimum monthly benefit of $130 per single recipient.

(2) The granting of the right to public assistance recipients to maintain their eligibility for another year despite the 1972 Social Security benefit increase of 20 percent.

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[1]The increment provision is interesting as it reflected, undoubtedly, an attempt to mitigate the demands for eliminating the retirement test. Officials recognized that the complete elimination of the test, as demanded by the elderly and income redistributionists, would have been extremely costly. The retirement test is rationalized on the grounds that the program is designed to offset loss of earnings in old-age, not to provide retirement benefits automatically at the age of 65.

As such, the 1972 Amendments constituted a comprehensive liberalization of the Social Security program. The increase in widow(er) benefits, the institution of special benefits for low paid workers, and heavy reliance on real taxable ceiling increases all reflected the growing demands for "social adequacy"--growing demands to redistribute income intragenerationally as well as intergenerationally.[1] The liberalization of the Hospital Insurance program, demanded since the program's inception in 1966 by the National Council of Senior Citizens, was also inevitable. It appears that the provision to allow poor OASDI recipients to continue receiving old-age assistance was simply a popular thing to do a month before a national election.

The creation of a federal public assistance program marked the culmination of years of debate over states' rights vs. "adequacy" and "equality." Since 1939, when the first change in matching formulas was enacted, conservatives had fought against increasing federalization. As Senator P. G. Gerry of Rhode Island remarked in April, 1939,

> When Uncle Sam offers the helping right hand of financial assistance to a state, he extends at the same time a grasping left hand toward the administrative jurisdiction of the sovereign beneficiary.[2]

On the other hand, Congressional liberals fought for many years to increase, continually, the federal matching share in categorical grants

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[1]Taxable ceiling increases were endorsed by the Advisory Council on Social Security, lobbies representing organized labor and the elderly, and the National Democratic Party.

[2]Cited in "Should the Powers of the Federal Government be Increased?" The Congressional Digest, Vol. XIX, No. 9, p. 221.

to states. Efforts by President Eisenhower during the 1950's to limit Congressional discretion in increasing the federal government's role in traditionally state welfare activities were fruitless and were followed by the implementation of nonuniform grants to states based on states' incomes, and larger average expenditures. It must surely have been the case that by the 1970's, much of the die-hard states' rights opposition to federalization withered as states' welfare expenditures mounted rapidly.

Amendments to the 1973 Renegotiation Act Extension Bill

Since 1973, Congressional legislation on Social Security had already increased benefits 51.8 percent on a cumulative basis compared to an 11.4 percent cumulative increase in prices, and enacted many program liberalizations when Congress went on, in 1973, to pass an 11 percent across-the-board increase in benefits effective the following year. In an unprecedented manner, a 5.9 percent cost-of-living increase was passed in last minute legislation on June 30, then was superseded by an 11 percent increase legislated December 21, 1973.[1]

As in 1971, the House Ways and Means Committee had been preparing a bill to extend the temporary national debt ceiling (HR 8410).[2] When the bill reached the Senate Finance Committee, non-germane amendments were attached which included an increase in Social Security benefits of 5.9 percent, to be effective in January, and an increase in the

[1] See *Congressional Quarterly Almanac*, Vol. XXIX, pp. 543-550, and 570-580.

[2] Ibid., p. 543.

Supplementary Security Income benefit to be effective the following year.[1] Only three days before the debt ceiling was to fall to its permanent level, the Senate had added amendments to the bill that on their own would have stood almost no chance of Presidential approval.

The House was unwilling to accept these revisions, so in conference, a compromise was reached to postpone the benefit increase until April and, further, to increase the taxable ceiling to help finance the added expenditures. On June 29, to the surprise of Representative Wilbur Mills and other House conferees, the House defeated the conference report. Objections included opposition to Senate tactics in adding the amendment to the debt ceiling bill, and the Administration's opposition to large spending increases. Gerald Ford (R.-Mich.), House Minority Leader, objected that neither the House nor the Senate committees had held hearings during 1973 on amending Social Security.[2]

Not yet stumped, on June 30, the Senate decided to attach the Social Security amendments to a pending Renegotiation Act extension bill (HR 7445) which also required passage that day. In a second meeting, conferees reached agreement on the Renegotiation Act and further postponed Social Security benefit increases to June, 1974.

As enacted, the Renegotiation Act Extension bill raised Social Security benefits 5.9 percent (June, 1974), liberalized the retirement earnings test, extended benefits to adopted grandchildren, and increased

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[1] Ibid., p. 570.

[2] Ibid., p. 549.

the taxable ceiling to $12,600 (January, 1974).[1] The Act also increased benefits which were scheduled to be paid to Supplementary Security Income recipients to $140 (June, 1974). Also benefit coverage under Supplementary Security Income was expanded; and a temporary extension was granted to Medicaid recipients so that they could maintain their eligibility for assistance despite the previous 20 percent increase in Social Security benefits.

Further Amendments in 1973

Before these amendments went into effect, and due to the rapid rate of inflation in 1973, HR 11333 was passed by Congress during December to supersede the earlier amendments of 1973. As passed, Social Security benefits were increased 11 percent in two steps: 7 percent in March, 1974, and 4 percent in June, 1974.[2] The taxable ceiling was further increased to $13,200 (January, 1974), without any change in tax rates. Also, the previous increase in Supplementary Security Income benefits was moved to January, 1974; and a second increase was legislated for July, 1974 ($146 for individual recipients, $219 for a couple). Finally, the method of computing automatic cost-of-living adjustments was changed in order to reduce the time lag between the calculation of the rate of inflation and its reflection in higher checks.

Although there was almost no opposition expressed to the benefit increases during Congressional debate of the bill, concern over the

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[1] For the details of the amendments, see Ibid., pp. 570-580.

[2] Ibid. By the time the 11 percent increase went into effect, prices had increased 16.4 percent since the last benefit increase.

future course of the Social Security program was expressed. On the floor, doubts were raised over the haste of the amendments' enactment, the program's fiscal future, and the program's equity.

Representative Broyhill (R.-Va.) remarked that every time amendments to the Social Security Act were considered, there was exhibited confusion over what was desired: an insurance program, as was enacted in 1935, or a welfare program, and how costly a program was desired. Further, as concern for the aged and disabled had mounted, benefits had been increased without regard for the long-range financial status of the trust funds. In his words, the trust funds were only "marginally sound." Finally, he remarked, payroll taxes had reached "acceptable limits . . . . We are soaking wage earners to pay for liberalized benefits."[1]

Representative Conable (R.-N.Y.) made a similar statement. While he intended to vote for the benefit increase, he admitted he feared it was the wrong decision. Moreover, if he really knew how repeated benefit increases were affecting the financial integrity of the system and the program's equity, he admitted, his vote would probably be different. "Frankly," he said,

> Nobody is worrying about where we are headed with Social Security. We would better not put off a careful review much longer if we are to face the next generation with as much sympathy as we are here showing to the last generation.[2]

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[1]Cong. Rec.(November 14, 1973), H9988-89.

[2]Cong. Rec. (November 14, 1973), H9995. It is not infrequent, in fact, that Congressmen voice fairly strong dissent on the issue of Social Security expansionism, yet because of the emergent political power of the elderly, vote for large benefit increases along with a package of program liberalizations.

Indeed, as shown in Tables 38 and 39, real annual expenditures on Social Security were already \$72.8 billion and the average benefit paid had reached \$205 in real terms. A family could actually earn a real monthly benefit as high as \$1,025.

TABLE 38

STATUS OF THE OASDHI TRUST FUNDS:1960-1976
(In billions of dollars)[a]

Year	Real revenues	Real expen-ditures	Real assets	Current exp./total assets
1960	$22.3	$21.2	40.9	.52
1965	30.3	32.5	33.7	.96
1970	59.3	52.9	57.1	.92
1971	61.8	59.0	57.1	1.03
1972	66.7	63.9	58.6	1.08
1973	79.2	72.8	61.3	1.18
1974	80.4	74.8	59.9	1.24
1975	80.3	79.4	54.7	1.45
1976	84.3	86.0	49.7	1.73

SOURCE: Department of Health, Education, and Welfare; Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973 (Washington, D.C.: Government Printing Office, 1974), pp. 61-63; and Social Security Bulletin, Vol. XL, No. 5, pp. 37-39.

[a]Calculated on the basis of 1975 dollars.

TABLE 39

BENEFITS PAYABLE TO RETIRED WORKERS: 1935-1973
(1975 Dollars)

Year	Minimum benefit	Maximum benefit	Average Benefit awarded	Maximum Family benefit
1935	$ 39	$333	$ --[a]	$ --[b]
1939	39	160[c]	87[c]	331
1950	45	153	69	335
1952	51	172	99	342
1954	60	197	122	401
1958	61	216	138	473
1961	72	218	138	457
1965	75	226	147	628
1967	89	252	144	701
1969	94	279	156	638
1971	94	287	184	688
1972	109	342	204	911
1973	114	383	205	1,025

SOURCE: Social Security Administration, Social Security Bulletin: Annual Statistical Supplement, 1973, pp. 84, 23; and History of the Provisions of OASDHI, p. 3.

[a]No benefits paid prior to 1940.

[b]No maximum family benefit.

[c]For 1940.

Chapter VI

THE "FISCAL CRISIS" AND PROSPECTS FOR REFORM

> As chief financial officer of the U.S. Government, I am required to assess the soundness of the Social Security System. My assessment covers both the system's current financial position, and its ongoing viability. I have been shocked by what I have learned . . . the future prospects of the system as we know it are grim.[1]

Introduction and Summary

While it appeared that there were few binding constraints on the ability of Congress to legislate indirectly large redistributions of income within and between generations during the Johnson and Nixon years, experience during the years 1975-1977 indicates that this is no longer the case. In fact, fairly widespread concern over the financial soundness of the system has led to a virtual halt in the creation of laws to liberalize and expand the program.

As of mid-1977, some four years after the Board of Trustees announced the emergence of "unexpected" long-run deficits, no action had been taken to alleviate the deficits. This should not be surprising as many of the traditional means of extracting additional funds have been all but exhausted--tax rates are thought to be reaching "politically acceptable" limits, coverage is nearly universal, and the

[1] William Simon, "How to Rescue Social Security," Wall Street Journal, Nov. 3, 1976.

ceiling on taxable earnings is above the level of 75-80 percent of all covered workers' earnings. This does not rule out the very real possibility that tax rates will be further increased (as the employer's share is often not recognized as a cost to the worker), the ceiling will be increased to cover all earnings, and that coverage will be made universal. Indeed, the demands of 32 million beneficiaries, many of the 100 million taxpaying workers who hope to become beneficiaries, lobbies representing the elderly and organized labor, Social Security officials, and other expansionists can hardly be offset by the warnings of fiscal conservatives. But, what would be the implication of these changes? They would be the admission of a complete dismissal of the institutional framework upon which the original program had been based; and the institutional redirection for the exploitation of a government program for redistributive purposes would have been essentially completed.

The concluding chapter of this study is devoted to an examination of both the sources of "fiscal crisis" and the prospects for reform. It appears evident that special interest groups, including the Social Security bureaucracy, have grown to include so many persons that broad demand-side reform, in an ideal sense, is impossible; yet for the first time in history, alternative sources of information are surfacing, without which rational choice would have been impossible.

The Sources of "Fiscal Crisis"

There are two essentially distinct problems now facing the Social Security system: actuarial deficits and political support. Whereas the recently announced short- and long-term deficits are simply actuarial "imbalances" in the trust funds that can be alleviated, conceivably, in any number of ways, the much more pressing problem is which, if any, of these means are politically feasible and what will be the impact of these changes on future political support.

The Short-Run Actuarial Problem: 1976-1985

The 1976 Board of Trustees to the Social Security trust funds reported that expenditures out of the trust funds will exceed revenues in each year from 1976 to 1981. Moreover, it was projected that the OASI and DI trust funds will be exhausted in 1981 and 1984 respectively.[1] A combination of factors, which include the 1972 Amendments and the 1973-1975 recession, are cited as having given rise to this short-term actuarial deficit.[2]

The 1972 Amendments, which introduced the automatic indexing provision and bestowed current beneficiaries with an across-the-board benefit increase of 20 percent, had been based upon cost and revenue projections which not only utilized imperfect earnings assumptions,

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[1] 1976 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, House Doc. 94-505, 94th Cong., 2nd Sess. (Washington, D.C.: Government Printing Office, 1976), pp. 41-66.

[2] See Alicia H. Munnell, The Future of Social Security, Brookings Study in Social Economics (Washington, D.C.: The Brookings Institute, 1977), pp. 84-111; Robert S. Kaplan, Financial Crisis in the Social Security System, Domestic Affairs Study No. 47 (Washington, D.C.: American Enterprise Institute, 1976); and "Propping up Social Security," Business Week (July 19, 1976), pp. 34-43.

but also a significantly outdated set of demographic assumptions. More specifically, the old level-wage assumption had been abandoned for more "reasonable" assumptions about the growth of earnings, while demographic assumptions developed in the early 1960's were utilized. By the time the 1972 Amendments were enacted, the Social Security Administration's average fertility rate projections were already some 30 percent higher than actual experience, and a severe economic recession was only months away.[1] Incorrect demographic projections in conjunction with double-indexing served to produce severe long-run deficits, whereas the 1973 recession was the major contributing factor to immediate actuarial deficits.[2]

To alleviate the short-run trust fund deficits, four primary changes to be enacted over the next eight years have been suggested. OASDI tax rates could be increased from their current level of 9.9 percent to 11.0 percent. The taxable earnings ceiling could be increased from its current level of $16,100 to $46,200. The ceiling on employers' tax payments could be eliminated altogether; or compulsory coverage could be extended to all government employees. Neither of these

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[1] See, in particular, Robert Kaplan, Financial Crisis in the Social Security System, pp. 4-8.

[2] The recession had the dual effect of lowering expected revenues by reducing employment and the trend rate of growth of earnings, and increasing expected expenditures by leading to higher retirement and disability claims. See Alicia Munnell, The Future of Social Security, pp. 95-99.

proposals, however, would have any major effect on long-run actuarial deficits.[1]

The Long-Run Actuarial Problem: 1976-2050

The long-run actuarial deficit of the OASDI system is estimated to be, on average, 7.96 percent of taxable payrolls, or $4.3 trillion. This figure implies that in the absence of Congressional action, only if $4.3 trillion were placed in the funds today, invested, and supplemented with the revenues from scheduled tax rates, could Social Security pay off all scheduled benefit payments.[2] Moreover, with a 7 percent market rate of interest, the size of the long-run deficit will double in the next ten years if unattended.

Shown in Table 40 are the deficits which have been projected during the past three years, and the tax rates deemed necessary to finance them. The markedly more pessimistic projections of the 1976 Board of Trustees are largely attributable to a new set of economic and demographic assumptions designed to reflect a relatively lower rate of growth of earnings and a reduction in average fertility rates. As shown in the table, the interaction of double-indexing and adverse demographic trends may necessitate tax rates in the order of 30 percent by

[1] See Subcommittee on Social Security of the House Committee on Ways and Means, Examples of Methods of Increasing Income into the Social Security Trust Funds, 94th Cong., 1st Sess. (Washington, D.C.: Government Printing Office, 1975), pp. 2, 6-7; and Robert Kaplan, Financial Crisis in the Social Security System, pp. 13-15.

[2] A. Haeworth Robertson, "OASDI: Fiscal Basis and Long-Range Cost Projections," Social Security Bulletin, Vol. XL, No. 1 (January, 1977), pp. 20-28.

TABLE 40

LONG-RUN PROJECTIONS FOR THE COMBINED OASDI TAX RATES
FOR SELECTED YEARS: 1975-2050

	Expenditures as a percentage of taxable payroll							
	Projections under present overindexed system						Projections under decoupled system	
Year	1975 law	1973 Trustees	1974 Trustees	1975 Trustees	1975 Senate Panel	1976 Trustees	1975 Trustees	1976 Trustees
1975[a]	9.9	9.7[b]	10.2	10.9	10.2	10.6	10.9	10.6
1990	9.9	10.0	11.0	11.2	11.5	12.1	11.1	11.8
2010	9.9	10.3	12.7	14.1	14.6	16.0	12.6	13.7
2030	11.9	12.5	17.6	21.8	23.3	26.0	17.2	19.4
2050	11.9	12.6[c]	17.9[c]	22.4	23.9	28.6	16.3	19.2
Average	11.0	11.0[d]	13.9[e]	16.3	16.9	18.9	13.8	15.2
Average deficit[f]	...	...	3.0	5.3	6.0	8.0	2.9	4.3

SOURCE: Alicia H. Munnell, The Future of Social Security, Brookings Study in Social Economics (Washington, D.C.: The Brookings Institute, 1977), p. 100.

[a]Figures from the 1973, 1974, and 1975 Trustees' Reports and from the Senate Panel are estimates done before the actual experience; the figures from the 1976 Trustees' Report are based on actual experience but are preliminary.

TABLE 40--Continued

[b]Estimate for 1973.

[c]Estimate for 2045.

[d]Average for 1975-2045.

[e]Average for 1974-2048.

[f]Additional yearly tax required for funds sufficient to meet total benefit costs and administrative expenses during the seventy-five year period.

the year 2050. In fact, the "technically" flawed inflation adjustment mechanism is expected to produce nearly half of the projected tax rate increases.

Alongside double-indexing, marked increases in the ratio of elderly to the working aged are expected to contribute to the long-run deficit. As shown in Table 41, the ratio of "retirees" to "workers" is expected to rise more than 70 percent from 19.2% in 1975 to nearly 33 percent in 2030. Interpreted somewhat differently, the persistent decline in fertility rates interacting with increasing lifespans are expected to generate a situation in 2030 in which there will be only 2.2 workers supporting each OASDI beneficiary.[1] At present, there are 3.3 workers per beneficiary.

Several means have been advocated for alleviating the long-run deficit, amongst which are the "decoupling" of the indexing provision; sizable increases in the tax rate; the elimination of the taxable earnings ceiling; the elimination of secondary benefits for dependents and survivors; and the partial or complete financing of some or part of OASDHI through general revenues.[2] More extensive reform proposals have been advocated as well.

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[1]Colin D. Campbell, Over-Indexed Benefits: The Decoupling Proposals for Social Security, Domestic Affairs Study No. 46 (Washington, D.C.: American Enterprise Institute, 1976), p. 9.

[2]See Robert Kaplan, Financial Crisis in Social Security System, pp. 9-13; and Alicia Munnell, The Future of Social Security, pp. 106-111.

TABLE 41

ACTUAL PAST AND PROJECTED DEPENDENCY RATIOS FOR SELECTED YEARS: 1930-2050[a]

Year	65 and over
1930	9.7
1940	11.7
1950	14.1
1960	17.4
1970	18.4
1975	19.2
1990	19.6
2000	19.3
2010	19.8
2020	25.8
2030	32.8
2040	32.6
2050	31.9

SOURCE: Alicia H. Munnell, The Future of Social Security, Brookings Study in Social Economics (Washington, D.C.: The Brookings Institution, 1977), p. 110.

[a]The dependency ratio is the total number of persons older than sixty-four per 100 persons between the ages of twenty and sixty-four.

The Political Problem

In any real sense, the existence of a "crisis" in the 1970's is political, not actuarial, and has been developing for many years. Indeed, the elimination of a funded program in 1939 was the elimination of an institutional obligation to rationally consider program expansion by necessitating the current financing of all future benefit promises.

What has been observed in the past forty years is the logical result of exploiting the redistributive potential of an intergenerational transfer program. Rather than expand coverage to capture the potentially higher rates of return from large-scale risk sharing, the extension of compulsory coverage to nine out of ten workers was used to pay out more and larger real benefits to current beneficiaries and postpone large tax increases. As adverse demographic trends have set in to reduce the number of future workers from whom to transfer income, discrete increases in real tax payments can no longer be postponed to the long-run. Importantly, a funded program would not have been affected by lower fertility rates since the system would have forced each generation to provide adequately for its own future benefits.[1]

With few exceptions, the theoretical work on the gains from a pay-as-you-go system has provided little insight into the political problems associated with such a program as it has been preoccupied with steady-state properties.[2] The Social Security program has certainly

[1]The economic and political differences between funding and a pay-as-you-go system are discussed more fully in Chapter IV.

[2]An important exception is Edgar Browning, "Why Social Insurance Budgets are Too Large in a Democracy," Economic Inquiry, VIII (September, 1975):373-388.

not attained, nor is likely to attain, such a state since amendments that change the rules of the game have been enacted nearly continuously since the program's inception. Moreover, the program is still relatively young as revealed by the fact that the generation of workers who entered the system in 1937 at the age of twenty-one has not yet retired under the system. While it is possible to view the history of the program as the transition to a steady-state intergenerational transfer program, one is then confronted with the very real possibility that the long-run tax rate required to sustain the program is politically unacceptable and could have emerged with broad-based support at neither the inception of the program, nor today if a renegotiation were possible.

As revealed in Chapters IV and V, a pay-as-you-go, intergenerational transfer program is thus a delicate mechanism that would require rules on the use of the current fund if it were to emerge, conceptually, with broad-based political support. It is interesting to note, however, that the fiscal crisis has been characterized as largely unexpected. This must certainly be due to the widespread confusion generated by Social Security bureaucrats that the program was guided by rules, i.e., that it was indeed fully funded. While fiscal conservatives had warned against too rapid expansion of the Social Security program since its enactment in 1935, it was not until Social Security officials, and their representatives, admitted to impending large financial deficits that their warnings were heeded.

Political Limits to Reform

Given the apparently unchecked growth of Social Security which was accompanied by not only the development of large trust fund deficits, but also a radical change in the nature of the program, reform of Social Security designed to introduce rules or institutional constraints on the future course of the program, and to clarify objectives seems clearly in order. From a positive perspective, however, the question of whether or not reform of the Social Security system can be effected must reckon with the very real problems of how many persons stand to lose from reform as well as the political power of losers relative to gainers. Importantly, the current system has bestowed entitlements to certain types of benefits that could have been provided neither in a competitive market setting nor under most alternative fiscal systems that have been proposed.

The Interest of Beneficiaries and Bureaucrats

The most important constraint inhibiting reform is likely to be the fact that there are presently 33.1 million beneficiaries of monthly cash benefits from the OASDHI program with vested interests in the maintenance of income flows. Table 42 shows both the distribution of these beneficiaries and the benefits to which they are currently entitled. As shown in the table, the average monthly benefit in January, 1977, ranged from a low of $158 for children of deceased workers, to a high of $244 for retired workers. Average family benefits are significantly higher. At a minimum, these benefits are expected to rise with the price level.

TABLE 42

OASDI BENEFICIARIES AND AVERAGE BENEFIT PAYMENTS: JANUARY, 1977

Beneficiaries	Payments
Monthly beneficiaries, total (in thousands)	33,142
Aged 65 and over, total	21,310
Retired workers	15,440
Survivors and dependents	5,685
Special age-72 beneficiaries	185
Under age 65, total	11,832
Retired workers	1,813
Disabled workers	2,682
Survivors and dependents	7,337
Total monthly benefits (in millions)[a]	$ 6,453
Average benefit in current-payment status:	
Retired workers	$225.39
Disabled workers	245.53
Aged widows and widowers	207.31
Children of deceased workers	152.34
Average benefits awarded:	
Retired workers	$244.86
Currently payable awards	237.62
Disabled workers	272.18
Aged widows and widowers	214.37
Children of deceased workers	158.58

SOURCE: Social Security Administration, Social Security Bulletin, Vol. XL, No. 5, p. 1.

[a]In current-payment status; excludes lump-sum and retroactive payments and adjustments.

More likely, they are expected to rise even faster because of either historical precedent or, at the least, the imperfect indexing provision that overresponds to inflation.

Table 43 not only provides further insight into the difficulty of effecting any major reform that would threaten future income streams for current beneficiaries and the near-elderly, but also helps explain the inability to "correct" double-indexing after five years. Shown in the table are replacement ratios for representative beneficiaries, or the ratio of Social Security benefits in the year of retirement to gross earnings the previous year. As illustrated, the low income worker retiring in 1975 received 61 percent of his gross pre-retirement earnings in Social Security benefits, whereas the worker who retired with an elderly wife and the same pre-retirement earnings received a benefit equivalent to 92 percent of his previous gross income. Since pre-retirement earnings are taxable and Social Security benefits are not, the low income worker can retire under Social Security and suffer no reduction in living standard. Because of the downward weighted benefit formula, replacement ratios decline as the worker's income rises.

Over time, and in the absence of Congressional action, the interaction of double-indexing and sustained periods of inflation are expected to produce a marked upward trend in replacement ratios for all beneficiaries at all income levels. Even holding the rate of inflation constant at 3 percent, replacement ratios for the low income worker and wife are projected to reach 128 percent in 2050.

While it is clear that married retirees with low earnings histories could not have purchased annuities of equal value with their tax

TABLE 43

REPLACEMENT RATIOS ASSUMING ANNUAL INCREASES OF 3 PERCENT IN WAGES AND 3 PERCENT IN PRICES

Year of attaining age 65	1974 Earnings		
	$3,200	$7,681	$13,200
		SINGLE	
1975	61%	43%	29%
1985	61	45	33
2000	66	46	34
2025	80	50	36
2050	86	52	38
		WITH WIFE AGE 65	
1975	92%	84%	44%
1985	91	68	50
2000	99	68	51
2025	120	74	55
2050	128	78	57

SOURCE: Colin D. Campbell, Over-Indexed Benefits: The Decoupling Proposals for Social Security, Domestic Affairs Study (Washington, D.C.: American Enterprise Institute, 1976), p. 12.

payments, an examination of replacement ratios provides no immediate measure of the proportion of gainers and losers under the current system, and therefore no immediate means of assessing the likelihood of demand-side pressures for reform. For this purpose, estimates of rates of return or cost-benefit ratios are necessary. According to preliminary estimates, the worker who retired between 1967-1975 as a worker-only beneficiary earned, on average, a real rate of return on combined tax payments of approximately 14.8 percent. Workers in the lowest income quartile earned rates of return as high as 25 percent, while workers in the highest income quartile earned a rate of return in the order of 8 percent.[1] Employing quite different empirical techniques, more recent estimates suggest that persons who retired in 1974 will earn benefits the present value of which exceeds the present value of their tax payments by a factor of 1.6 to 2.5.[2] Accordingly, it has been estimated conservatively that nearly 22 percent of all OASI benefit payments in 1971, or \$6.4 billion (\$8.5 billion), were unearned in an actuarial sense.[3]

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[1]See Alan Frieden, Dean Leimer, and Ronald Hoffman, "OAI Internal Rates of Return: Some Preliminary Results from Individual Earnings Histories," (Mimeographed, Social Security Administration, 1975), pp. 1, 13. These calculations are based on actual earnings and projected benefits of worker-only beneficiaries. As such, they understate the rate of return payable to workers with dependents.

[2]Attiat Ott and Davit Ott, "Social Security: Problems and Prospects," (Mimeographed, 1975). Similar estimates have been made by Colin D. Campbell in "Social Insurance in the United States: A Program in Search of an Explanation," Journal of Law and Economics (1969).

[3]Attiat Ott and David Ott, "Social Security: Problems and Prospects," pp. 48-49.

On the beneficiary side, then, Social Security has afforded a lucrative "investment" for most retirees relative to both the market and to a pay-as-you-go system in the long-run. Moreover, from the point of view of Social Security bureaucrats, the program has provided an attractive and secure source of employment. Between 1965-1975, real per capita social insurance expenditures grew at an average annual rate of 10 percent relative to a 2 percent average annual rate of growth of real per capita disposable income.[1] By 1976, the program had grown to become the largest domestic government program in the United States, spending $92 billion a year, of which $1.6 billion was attributable to administrative expenses alone.[2] Whether this rapid growth is seen to be a response to the demands of expansionary special interest groups or an active bureaucracy, Social Security has amassed such proportions that it is unlikely that any major reform proposal could be viewed by bureaucrat-beneficiaries as "discretion-enhancing."

It should be clear, therefore, that both current beneficiaries, the near-elderly, and Social Security bureaucrats will actively oppose any reform proposal that cannot "guarantee" the continuation of their benefit streams. Indeed, in the midst of a "fiscal crisis," Social Security officials describe the system as one that is "sound and durable

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[1]Figure includes unemployment compensation. See Martin Feldstein, "Social Insurance," Paper presented to American Enterprise Institute conference on income redistribution, May 20-22, 1976, p. 1.

[2]Figure includes all expenditures out of the OASDHI trust funds. See Social Security Administration, Social Security Bulletin, Vol. XL, No. 5 (May, 1977), pp. 37-39.

and of great value," and the American Association of Retired People demand not only price indexed benefits, but also benefits indexed to the rate of growth of gross national product.[1]

The Interests of Taxpayers

On the taxpayer side, assessing the likely proportion of gainers and losers under reform is considerably more complex; for indeed, the Social Security system has been modified so frequently that projections of future benefits and tax payments under the current system are suggestive at best. Making certain restrictive assumptions about the future course of the economy and Social Security, however, one study estimates that more than two-thirds of all male workers, or all those under the age of forty-four to fifty-four will be net losers under the current system, in the sense that the present value of their life-time taxes will exceed the present value of future benefits.[2] Should the costs associated with being coerced to "save" more than preferred or to "save" in a less preferred time pattern be taken into account, along with recently updated adverse demographic and earnings trends, the proportion of losers under the current system would be significantly higher.

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[1]See statement by five former Secretaries of the Department of Health, Education, and Welfare, The Sound and Durable Institution of Great Value (Washington, D.C.: U.S. Department of Health, Education, and Welfare, 1975); and Harriet Miller, "Sharing the Growth They Helped Create," News Bulletin of the American Association of Retired People, Vol. XVIII, No. 5 (May, 1977), p. 6.

[2]Attiat Ott and David Ott, "Social Security: Problems and Prospects," pp. 29, 32. Similar estimates have been made by Colin D. Campbell, "Social Insurance in the United States," Journal of Law and Economics (1969).

On the other hand, even if it were possible to posit that most taxpayers, or more than 50 million workers, will be pure losers under the current system, how does this translate into effective demands for program reform? Importantly, in a majority voting context with imperfect information, it will be not only the political power of voter coalitions rather than their absolute size that determines the outcome of the collective choice process, but also the perceptions most taxpayers hold about the current system rather than objective phenomena that will condition their demands for program reform. For this reason, a number of factors can be expected to mitigate effective taxpayer support for program reform with the result that Social Security, as we know it, may indeed have a life that can be "measured in centuries."[1] Not surprisingly, these are the same factors that help explain why the rapid growth of Social Security had not been curtailed any earlier.

Perhaps the most formidable obstacle to major reform of the program is the fact that the costs of obtaining accurate information on individual costs and benefits under the current and alternative systems is significantly, if not prohibitively, higher for taxpayers than for beneficiaries. In the absence of competing suppliers of viable substitutes, the voter-taxpayer has had no immediate way of assessing rates of return payable under a pay-as-you-go system. Instead, he may rationally have relied on the most readily available information: either that obtained by observation of the very high rates of return that have

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[1] Paul A. Samuelson, "Social Security: A-OK," <u>Newsweek</u>, April 14, 1975, p. 74.

already been paid or that provided by Social Security bureaucrats--those least motivated to publicize the necessarily declining rates of return payable under a "maturing" pay-as-you-go system, or the cost savings associated with certain reform proposals. In either case, the information upon which voters have had to make judgments has been biased in favor of the maintenance of the current system.

While the notion which was advanced for many years by the Social Security bureaucrats, in particular, that the program was funded, is being largely eroded in the presence of a "fiscal crisis," the same cannot be said for the notion that the employee pays only one-half of the total payroll tax. To the extent that taxpayers continue to misperceive the true incidence of the employers' tax and, to a lesser extent, ignore completely the impact of Social Security on capital accumulation, pessimistic cost-benefit calculations overstate by more than twofold the ratio of costs to benefits as perceived by voter-taxpayers. In other words, if it is the case that voter-taxpayers perceive less than fifty percent of their true tax burden, then the proportion of workers that can be expected to actively endeavor to control Social Security is surely well below the number implied by a simple count of "losers."[1]

The problems associated with reforming Social Security in the presence of high costs of obtaining information as well as the ready availability of biased information are then compounded by the pervasive phenomena that lobby groups tend to be disproportionately representative

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[1]This figure might be as low as 17-20 percent if one includes an 11 percent reduction in GNP as unperceived. See Edgar Browning, "Why Social Insurance Budgets are Too Large," Economic Inquiry (1975), p. 385.

of expansionary, beneficiary groups. Even with unbiased information, the existence of fiscal institutions which distribute tax costs across not only millions of workers, but also millions of non-voting future workers, reduces the incentive of taxpayer groups to invest resources in lobbying by dispersing widely the potential gains from tax-saving reforms. Moreover, those most likely to be intensely opposed to the continuation of the current system--those who are scheduled to bear tax rates on the order of 30 percent--have not yet been born. Indeed, for worker-taxpayers, reform of Social Security has many attributes of a pure public good for which the benefits would even be shared by future taxpayers.

While it might appear that the interests of a well-informed young covered worker would be diametrically opposed to the interests of the self-interested beneficiary as the former stands to lose considerably under the current system, this is not, in fact, entirely the case. Because of peculiar features in both benefit eligibility requirements and the pay-as-you-go system, Social Security produces vested interests in the maintenance of the program even among the youngest workers. More specifically, the largest proportion of fully-insured workers and workers insured in the event of disability are actually under twenty-five to thirty years of age; and by nature of a pay-as-you-go system which accumulates no reserves, the abandonment of Social Security assures a rate of return of minus one for anyone who has paid any taxes at all.[1] Alternatively stated, alongside the interests of more than 30 million direct beneficiaries who are eligible for and "entitled" to $700 billion of future benefits, there are the interests of more than 100 million taxpayers who have already accrued eligibility for $3 trillion of future benefits.[2]

One must certainly question the feasibility of effecting a broad-based demand-side reform of a program for which the value of all government "promises" outstanding exceeds the 1975 federal budget by approximately tenfold, particularly since the bureaucracy has become the dominant source of information on the current program and "reasonable" alternatives. Indeed, as the present study reveals so aptly, "The power of the bureaucracy . . . rests more in the suppression of information, particularly about alternatives, than its ability to push through changes that [voters] do not like."[3]

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[1]See Social Security Administration, Social Security Bulletin: Annual Statistical Supplement (1973), p. 78. More specifically, a worker is "fully-insured" if he has one calendar quarter of covered employment for each year elapsed between 1950 or the year of attaining the age of twenty-one (whichever is later), and the year before insurance status is determined. Since more than nine out of ten jobs are now covered by Social Security, the proportion of young, fully-insured workers will steadily increase. See Ibid., p. 11.

[2]This $3.7 trillion figure is the "unfunded liability" which is a present value and quite distinct from the "actuarial deficit" of $4.3 trillion. The unfunded liability is defined as the present value of benefits that have been earned or accrued as of a given date (in these figures, 1976). As such, its magnitude would be unaffected if tax rates were increased and the actuarial deficit eliminated. The actuarial deficit is the present value of the excess of planned expenditures over planned revenues over the course of the next seventy-five years. See A. Haeworth Robertson, "OASDI: Fiscal Basis and Long-Range Cost Projections," Social Security Bulletin, pp. 25-27.

[3]Douglas G. Hartle, A Theory of the Expenditure Budgetary Process.

In sum, the political feasibility of reform must be evaluated according to: (1) its actual and perceived impact on voters; (2) the relative political power of voter coalitions; (3) the actual and perceived impact on the monopoly position of the bureau; and (4) the bureau's relative control over the production of information and the generation of alternative proposals. Without fairly extensive empirical work on the impact of alternative institutional arrangements in the United States and abroad, however, the task of evaluating the feasibility of any particular reform proposal is speculative at best. On the other hand, the perspective gained by an examination of the evolution of Social Security should provide insight into the types of reform proposals that can be clearly ruled out as politically infeasible, and the types that remain viable or even likely alternatives in the near term.

In the next section of this chapter, three major reform proposals are considered. Although they represent only a sample of the many proposals that have been advocated, they reveal both the range of alternative proposals, the wide differences in those problems deemed most in need of reform, and the difficulty of politically implementing any major reform of Social Security. The first proposal focuses on the efficiency gains of permitting individuals freedom of choice over private and public producers of compulsory insurance; the second focuses on the efficiency gains of creating a fully-funded social insurance system; while the latter focuses on the ability to postpone the fiscal crisis by general revenue financing federal hospital insurance.

Alternative Reform Proposals

Social Insurance Bonds

As early as 1968, James Buchanan proposed a system in which the purchase of old-age insurance would have been compulsory, but individuals would have been free to choose a private or public producer.[1] In essence, the worker would have been compelled to purchase a politically determined minimum amount of private insurance each year, or to invest an equivalent amount in special government bonds, redeemable at retirement age. For current retirees and workers who had already contributed to the old system, these bonds would have been made available on a gratuitous basis according to their earnings histories.

As formulated, the plan would have been designed to rid Social Security of its redistributive function, clarify its insurance objective, and eliminate the Social Security Administration's monopoly over old-age insurance. It is a particularly interesting proposal as it is similar in many ways to the Clark Amendment of 1935.[24] Its similarities are, however, the sources of its political infeasibility.

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[1]James M. Buchanan, "Social Insurance in a Growing Economy: A Proposal for Radical Reform," National Tax Journal, Vol. XXI, No. 4 (December, 1968), pp. 386-395.

[2]Recall that the Clark Amendment proposed that firms be given the option to "contract out" of the public program if they could provide at least as generous benefits and collect premiums at least as high as under the public program. The individual would have had a free choice between the public or private system. The amendment led to more heated debate than did any other amendment to the original Social Security Act and ultimately stalemated the conference committee. See Chapter III.

From the point of view of worker-taxpayers, either the Clark Amendment or the Buchanan proposal would be clearly desirable as both were designed to ensure that no one would be worse off than under the public program by providing them free choice between programs. The same cannot be said for their impact on Social Security bureaucrats and politicians. The introduction of competing suppliers, voluntary patronage flows, and simple and clearly defined objectives would all enhance the information made available to resident-voters, increase the monitorability of the public output, and by eroding the monopoly position of the bureau, present a serious threat to the viability and future growth of the public program. Moreover, by eliminating the complex and redistributive features of Social Security, an important election issue for politicians would be eliminated as well.

Indeed, whereas the Clark proposal provided no reward for social insurance advocates who had invested heavily in seeking public legislation, the Buchanan proposal provides no compensation for politicians and bureaucrats who now have expected "income" flows associated with the growth and continuance of Social Security. The fact that these may be illegitimate claims in a democratic society does not negate their importance in a majority voting context with imperfect information and bureaucratic franchise. Finally, the Clark proposal met intense opposition by a group of social insurance advocates that had not yet been institutionalized into the Social Security bureaucracy, but already effectively dominated the information presented Congress. The Buchanan proposal would be met with intense opposition by a significantly larger and more influential group of social insurance advocates that is now federally funded to disseminate information and draft legislation, with the largest public information staff in the world at its disposal.

The fact that the Buchanan proposal is politically infeasible does not imply that it is unimportant. To the contrary, it serves the purpose of exposing the redistributive nature of the existing Social Security program, and providing a radical alternative to it. As Buchanan said, "effective social policy in this, or any other area, requires a continuing critical examination of the institutions we observe and which should be designed to serve our objectives.[1]

An Endowment Fund

More recently, Martin Feldstein proposed that Social Security be put back on a fully-funded basis.[2] According to his scheme, relatively high tax rates would be imposed now so that eventually the accumulating fund would be sufficient to pay off all future liabilities with a tax rate of zero. Unlike the Buchanan reform proposal which was designed to improve efficiency by eliminating the government's monopoly, regain and clarify insurance objectives, and provide freedom of individual choice, Feldstein's proposal is advanced simply as a means of improving future consumption possibilities by eliminating the depressing effect of a pay-as-you-go system on capital accumulation.

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[1] James Buchanan, "Social Insurance in a Growing Economy," p. 395.

[2] See Martin Feldstein, "The Optimal Financing of Social Security," (Mimeographed, Harvard University, 1974); and "Toward Reform of Social Security," Public Interest, No. 40 (Summer, 1975), pp. 75-95.

While Feldstein's analysis shows that a majority of voters can be made better off under his reform proposal, the difficulty with implementing such a scheme is that the link between an endowment fund and individual welfare is not obvious. Instead, it relies on a sophisticated understanding of not only the impact of capital accumulation on economic growth, but also labor supply effects.

As discussed in Chapter III, however, the decision to finance Social Security on a pay-as-you-go basis in 1939 and abandon the fund was a political decision, not a decision based on the economics of funding. The interests of the elderly, the near-elderly, politicians, and bureaucrats could all be best served by distributing the proceeds of the \$1.7 billion (\$6.6 billion) accumulated trust fund.

It is for this reason that Feldstein's proposal would undoubtedly lack support even from taxpayers; for without effective rules on the use of the fund, there would remain the possibility that worker-taxpayers could be made even worse off than under the current system. Indeed, once very high tax rates had been imposed in order to immediately accumulate a very large fund, the unconstrained distribution of the fund in windfall gains to current beneficiaries would create claims on the system and future generations significantly larger than those existing today. Just like the current pay-as-you-go system, the proposed system lacks competing suppliers and, therefore, readily available information on rates of return payable and the assurance that tax rates would, in fact, be reduced in the future. The constraints on the use of the fund that would be necessary for broad-based political support would, however, meet open opposition from politicians and bureaucrats.

General Revenue Financing

In 1975, the most recent Advisory Council on Social Security recommended financing the health insurance portion of Social Security through general revenues, and financing the remainder of the program by increasing the ceiling on taxable earnings and applying previously scheduled health insurance tax rates to the OASI and DI trust funds.[1] Unlike either of the two former proposals, general revenue financing of health insurance would simply be a means of relieving long-run deficits and, in so doing, forestall major reform of OASDI.

Partial or complete financing of Social Security has been advocated periodically since the inception of the program in 1935 by income redistributionists, yet the proposal has failed to gain broad political support from voter-taxpayers because Social Security has been viewed to be an earnings-related "insurance" program, and from Social Security bureaucrats because of its likely impact on their discretionary control. The payroll tax with its uncertain incidence and private insurance analogy has provided a secure source of revenues, immune to the annual Congressional review process.[2]

[1]U.S. Advisory Council on Social Security, Reports of the Quadrennial Advisory Council on Social Security (Washington, D.C.: Government Printing Office, 1975). Notice that this is an unusual way of suggesting that OASDI tax rates should be increased.

[2]Preliminary empirical estimates on the determinants of Social Security expenditures internationally show that general fund financing is associated with lower per capita expenditures on the elderly. See Joseph Pechman, Henry Aaron, and Michael Taussig, Social Security: Perspectives for Reform, pp. 294-304.

It is this fact that has led the Social Security Administration and all previous advisory councils to agree that

> the Social Security program has won widespread acceptance largely because those covered earned their Social Security protection by working and because they pay toward the cost of the protection through earmarked, earnings-related contributions,[1]

and that "policy decisions affecting the Social Security program should be based on the objectives of the program rather than on any effect that such decisions might have on the federal budget."[2]

With the onset of a fiscal crisis in the 1970's, however, the 1975 Advisory Council recommended general revenue financing of health insurance--the most likely candidate of the three social insurance programs because of its clearly non-earnings-related character. The likelihood of implementing their proposal is significantly more likely than in previous years, particularly as current beneficiaries and the near-elderly have come to question the financial soundness of the system and the duration of their expected benefit streams, and as serious doubts over the equity of the exemption of government employees from compulsory coverage have surfaced.

The likely impact of general revenue financing on political support and future growth is not clear. On the one hand, general revenue financing would have the effect of making voter-taxpayers aware of the redistributive nature of the program and lead ultimately to the integration of existing public welfare programs with Social Security. On the

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[1]U.S. Advisory Council on Social Security, Reports of the U.S. Advisory Council on Social Security (1971), p. 60.

[2]Ibid., p. 12.

other hand, the ability of voter-taxpayers to better perceive true tax costs under general revenue financing and constrain expansionary demands for redistribution is questionable in light of the rapid growth of such redistributive programs as Aid to Families with Dependent Children.[1] The fact that general revenue financing of Social Security would dramatically alter the nature of the program by financing progressive benefits by a progressive revenue source is clear.

Social Security in the Near-Term

Considering the interests and political power of beneficiary groups and Social Security bureaucrats, the most probable changes to be enacted in the near-term are tax rate increases and large taxable ceiling increases, whether they be applicable to the employer only, or to both the employee and employer. As shown in Table 44, there is a well established precedent for very high OASDI payroll taxes in other countries. Among the fourteen countries included in the table, only three countries (Switzerland, Japan, and France) have lower payroll taxes than in the United States, whereas tax rates are as high as 20-25 percent in Austria, Norway, and the Netherlands.

Table 44 also indicates that there is a clearly established precedent for imposing significantly higher payroll tax rates on employers

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[1]See James Buchanan, "The Economics of Earmarked Taxes," Journal of Political Economy, Vol. LXXI (October, 1963), pp. 457-469; and Richard E. Wagner, "Revenue Structure, and Budgetary Choice," Public Choice, Vol. XXV (Spring, 1976), pp. 45-62, for an analysis and empirical test of the impact of general fund financing on enhancing bureaucratic control.

TABLE 44

EMPLOYEE-EMPLOYER PAYROLL TAX RATES BY TYPE OF PROGRAM FOR SELECTED COUNTRIES: 1973

Country	All social security programs			Old age, invalids, and survivors insurance[a]		
	Total	Employee	Employer	Total	Employee	Employer
Austria	34.80	13.40	21.40	17.50	8.75	8.75
Belgium	39.85	10.40	29.45	14.00	6.00	8.00
Canada	10.00	4.70	5.30	3.60	1.80	1.80
Federal Republic of Germany	31.20	14.35	16.85	18.00	9.00	9.00
France	39.15	6.64	32.51	8.75	3.00	5.75
Italy	54.16	7.05	47.11	20.65	6.90	13.75
Japan	17.59	7.35	10.24	6.40	3.20	3.20
Netherlands	51.40	24.00	27.40	19.80	14.55	5.25
Norway	25.90	9.20	16.70	25.90	9.20	16.70
Spain	70.82	10.05	60.77	19.00	5.00	14.00
Sweden	23.70	9.65	14.05	16.18	5.68	10.50
Switzerland	24.32	6.75	17.57	8.60	4.30	4.30
United Kingdom	13.46	6.57	6.89	12.47	6.00	6.47
United States	14.60	5.85	8.75	9.70	4.85	4.85

SOURCE: Alicia H. Munnell, The Future of Social Security, Brookings Study in Social Economics (Washington, D.C.: The Brookings Institution, 1977), p. 108.

[a]Includes financing for some programs in addition to old age, invalids, and survivors insurance in the Netherlands, Norway, Spain, and the United Kingdom. Excludes financing for certain programs in Belgium and France that are covered by separate taxes under other programs.

than on employees. Seven out of the fourteen countries impose tax rates that are most frequently more than 80 percent higher than on the employee. In Spain, the tax rate on employers is 180 percent greater than the tax on employees.

Moreover, within the United States, there has been a well established precedent of financing additional Social Security expenditures through large increases in the ceiling on taxable earnings. Between 1966 and 1976, the real maximum individual tax payment increased 85 percent, of which more than half of this increase was due to real increases in the taxable ceiling.[1] Either a complete abandonment of the earnings ceiling, or an abandonment of the earnings ceiling on employers have both been advocated recently.

Proposals to raise the employers' tax rate or raise the tax ceiling on employers' tax payments will be particularly difficult occurrences to constrain as they are rational policies for social insurance advocates to pursue; for indeed, they provide attractive means of disguising the true incidence of added cost burdens on workers. Moreover, increases in the taxable ceiling, whether applicable to both the employee and employer or to the employer alone have been advocated for many years by representatives of the elderly and organized labor because they redistribute the full burden of financing additional expenditures onto the minority of higher income workers whose earnings are above the previously existing ceiling, and produce windfall gains for current beneficiaries and the near-elderly. It is for this reason that taxable ceiling increases are

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[1] See Table 33.

the most likely change forthcoming--the number of gainers, who include current beneficiaries, the near-elderly, and all those persons with earnings below the ceiling, clearly exceeds the number of losers, who include the minority of workers above the ceiling.

Whether or not the correction of over-indexing and the expansion of compulsory coverage to government employees can be accomplished in the near-term will certainly attest to the political power of beneficiary groups and government employees. Since over-indexing is expected to produce roughly half of the long-run deficit and, therefore, be responsible for nearly half the necessary tax rate increases, the enactment of decoupling seems all but imminent.[1] On the other hand, decoupling has seemed imminent to most observers for the past three years. Regarding the coverage of government employees, the emergence of a "fiscal crisis" and the need for new revenue sources has made this change far more likely than in the past.[2]

Whereas opposition to the expansion of coverage to government employees who already had a well established public retirement system has been defended for many years as inconsistent with the limited coverage objective of the original program, it is now clear that original objectives are not consistent with current practice. Increases in the

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[1]"Decoupling" proposals involve indexing worker's average monthly earnings before computing benefits. For a thorough discussion of the major alternative proposals, see Colin D. Campbell, Over-Indexed Benefits.

[2]Rather than extend full compulsory coverage to government employees, proposals are designed to integrate the federal retirement system with Social Security as was done with the Railroad Retirement system in the 1950's.

minimum benefit payable and reductions in eligibility requirements over the years have had the dual effect of holding down federal-state expenditures on old-age welfare and at the same time making "double-dipping" more attractive for government employees. In particular, more than 40 percent of all civil service retirees draw Social Security benefits as well, and nearly one-third of these "double-dippers" are drawing benefits on the minimum average monthly wages in covered employment.[1] Because of the downward weighted benefit formula, therefore, such a worker earns a benefit well over 100 percent of his average covered wages.[2]

Recognizing the large redistributive elements of Social Security today and the tax savings for non-covered workers associated with the historically declining role of general revenue financed old-age welfare, there remain no reasonable defenses of the exclusion of government employees from compulsory coverage. On the other hand, there have not been any sound defenses of their exemption for the more than twenty years since limited coverage and individual equity were effectively abandoned as objectives of the program.

The Future of Social Security

What is evidenced most clearly by both the types of institutional changes that are likely to take place in the near-term as well

[1]U.S. Advisory Council on Social Security. Reports of the Quadrennial Advisory Council on Social Security (1975), pp. 45-47.

[2]In 1974, this would have been 120 percent of the minimum average monthly earnings; see Ibid., pp. 19-25.

as the nature of the vast majority of reform proposals that have been advocated is that the choice of bureaucratic supply tends to presuppose a continuation of bureaucratic supply. In essence, it carries with it the very real cost of putting a "straightjacket on evolution."[1] By removing an activity from the competitive forces of the market process, alternative sources of information and truly radical reforms are sacrificed.[2] When this phenomenon is combined with the peculiar nature of a pay-as-you-go system in which how any particular generation will fare depends on the extent to which it can coerce the forthcoming generation, the continuance of Social Security, as we know it, seems all but inevitable.

On the other hand, one cannot ignore the pervasive uncertainty that characterizes the future. Indeed, "if we are to advance, we must leave room for a continual revision of our present conceptions and ideals which will be necessitated by future developments.[3] Importantly, for the first time in the history of Social Security, the onset of a "fiscal crisis" is witnessing the emergence of competing sources of information, without which rational choice would have been impossible.

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[1]F. A. Hayek, The Constitution of Liberty, p. 304.

[2]It is for this reason that Buchanan's proposal is valuable even if not politically feasible--it provides a radical alternative.

[3]F. A. Hayek, The Constitution of Liberty, p. 23.

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THE EMERGENCE, GROWTH, AND REDIRECTION OF SOCIAL SECURITY: AN INTERPRETIVE HISTORY FROM A PUBLIC CHOICE PERSPECTIVE

by

Carolyn L. Weaver

(ABSTRACT)

In an overall sense, the purpose of this study is to analyze and interpret, from a public choice perspective, the emergence, redirection, and growth of Social Security. To date, there has been no attempt to explain the evolution of this program within an integrated framework of non-market institutional change which incorporates both the recent literature on the economics of bureaucracy with the more traditional literature on the demand for public sector activity. As such, this study represents an endeavor to recast and review the historical-institutional evolution of Social Security, taking account explicitly of a theory of bureaucracy, so that the current and future growth as well as the proliferation of the program need not be viewed as entirely unforeseen and with results that are often unpredictable. Alternatively, this economic, political, and institutional case-study of Social Security can be viewed as a preliminary test of the relative explanation power of pure demand- and pure supply-side models of public sector growth.