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In Britain the vital questions are still unanswered. The private sector has done a great deal to meet the country's pension requirements—about one-half—and so far the state has barely advanced outside the area of basic subsistence pensions into the area of wage-related pensions. Whether it will do so is still an open question. I guess that it will, though to what extent I will not forecast. Still more open, however, is the question whether, if the state does enter that area, it will have a monopoly or whether the state and the private sector can live alongside each other. The present government scheme, with its system of contracting-out, encourages the hope that they can live together happily ever after. But, like so many novels which end with the marriage of hero and heroine, you are left with a nagging doubt whether the two are really suited to each other.

THE UNITED STATES

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Looking back over the years, the same major pension problems have been under discussion in Canada, Great Britain, and the United States—either at the same time or at different times. These problems include:

1. The roles of the individual, the employer, and government in providing income protection.
2. Principles involved in the formulation, administration, and financing of social insurance.
3. Contracting-out of government programs.
4. Tax incentives for private pension plans.
5. Supervision and regulation of pension plans.
6. Portability of pensions.

The actual designs of plans and methods used by each country to handle those problems are often different, and rightly so. They should, and presumably do, take into account the political, social, economic, and other pertinent conditions of the respective countries.

In other words, a plan which is appropriate for one country may be quite inappropriate for another. Hence, I would not assert that, because (as I think is the case)the federal Old-Age and Survivors Insurance Plan is a realistic and good approach for the United States, it should be the pattern to follow in any other country. Likewise, just because a particular type of plan appears to operate satisfactorily in some other country does not necessarily mean it would also be appropriate for conditions in the United States.

It goes without saying that a quite different, and probably more difficult, set of problems is present when it is a question of changing from one

type of plan to another than when the question is what, if any, plan should be set up in the beginning. And a plan which might be appropriate in a country at a given time might be inappropriate at another stage in its development.

With these prefatory remarks, let us turn now to each of the three areas of income maintenance under social insurance—retirement income, disability income, and unemployment insurance—in the United States.

I. RETIREMENT INCOME

The mechanisms developed in the United States for achieving retirement income protection include:

1. Individual plans—personal insurance, retirement income, homeownership, savings, investments, etc. They enable the individual to set up a program meeting his own needs and desires. This is the oldest approach.
2. Group plans—insured and trusteed employee retirement plans—set up by employers unilaterally or jointly with employees. This has been an important approach during the past few decades.
3. Government plans—better known as social security. This has become important only in more recent years.

Each of these approaches—individual, group, and government—has a special and necessary function of its own, which need not, and should not, compete with or overlap the others. Each should derive mutual support from the others and perform its role better because of their existence. When properly co-ordinated, we may picture them as a three-legged stool affording firm and well-rounded support for the citizens. A major strength of this triple support is its wide scope and diversity.

Social insurance.—The federal old age insurance plan is often referred to as "social insurance," and I think properly so—provided it is recognized that "social insurance" is not the same as individual insurance or group insurance.

Social insurance, the newest leg of our metaphorical stool, shares the name "insurance" with the other two by reason of certain broad resemblances, notably the automatic availability of benefits on the occurrence of specified contingencies and the fulfillment of set conditions. Nevertheless, it also has unique characteristics which mark it off from individual insurance. They may also be different for different fields in social insurance. For old age income they include:

1. The "social" character of the risk. This means the risk presents a threat to the individual's human and financial resources serious and widespread enough to warrant society's stepping in to organize preventive or ameliorative measures.

2. Coverage required for all to whom it can reasonably and practically be applied.
3. Level of protection limited by its basic purpose of social adequacy. The amount of protection furnished should be no more than is required to keep the breadwinner and his family from becoming public charges. That much is in the public interest, and has been described as "social adequacy." Meeting further wants and desires of individuals or groups is properly the function of private initiative, which should not be undermined.
4. Individual equity not required.[1] In compulsory social insurance, where coverage and contributions are required, the amount of, and contributions for, a covered individual's protection need not be based on "individual equity." Dropping this as a requirement permits the plan to achieve more readily its purpose of protection based on "social adequacy."
5. Benefits a statutory, not a contractual, right.[2]
6. "Full reserve" not required; some reserve accumulation may be desirable for contingencies or other practical considerations.[3]

[1] The term "individual equity" refers to that actuarial relationship which, under a voluntary insurance long-term arrangement, must obtain between the amount of the individual's protection and the premium therefor. Without this relationship a voluntary insurance plan could become financially inoperable through cancellations on the part of those who feel they are not being treated equitably and can do better elsewhere. Since premiums paid by the remainder would then be inadequate, the plan would go out of existence without having adequately funded its outstanding obligations, which could not therefore be discharged in full.

In long-term compulsory social insurance, on the other hand, where coverage and contributions are required, the amount of, and contributions for, a covered individual's protection need not be based on "individual equity." Dropping this as a requirement permits the plan to achieve its purpose of protection based on "social adequacy." Since the plan is assured a continuing income from new members, its obligations to any generation of members can be discharged in full without being fully funded.

[2] An individual's right to social insurance benefits depends on legislative enactment. It is statutory rather than contractual in nature. While the legislature promises benefits to certain persons under certain conditions, it can, if it sees fit, modify these benefits and conditions. Thus, Congress has on several occasions increased benefits because of changes in earnings and price levels. As demonstrated in 1958, Congress can also increase contribution requirements in the interests of solvency. Though it has not done so, it can also curtail benefits in the interests of solvency.

[3] In dealing with long-term risks, or hazards that increase with age, private individual insurance must have in reserve a fund which, invested to earn reasonable interest, will be sufficient to meet its obligations should it become necessary at any time to dissolve the plan. This concept of "full reserve" is also often used for private pension plans.

Since social insurance commands a continuing income not at the mercy of individual decisions of its members, it does not need to lay by funds to discharge long-term obligations in the event of a possible dissolution. It *could*, therefore, operate simply by taking in contributions at a rate sufficient to currently meet its benefit commitments

7. Investment of funds restricted to United States government obligations.[4]
8. Actuarial balance through "open-group" forecasting.[5]

During most of the past twenty-five years, a major task has been to correct and improve the design and coverage of the federal plan to bring it into accord with proper social insurance principles. That has been substantially accomplished, and the emphasis should now be on maintaining

and administrative costs as they emerge, without any accumulation of funds, i.e., on a strictly "pay-as-you-go" basis.

Both the "full reserve" and the "pay-as-you-go" concepts in these extreme forms raise formidable problems for a social insurance plan, and neither was adopted for federal Old-Age and Survivors Insurance. Instead Congress has recognized the need for a contingency reserve, with the degree of reserve financing desirable for the old age social insurance plan determined from time to time primarily on practical considerations peculiar to that plan and not on the actuarial considerations often used for private pension plans.

This financing method, which has been termed a "limited reserve" approach, has functioned satisfactorily to date. The reason, no doubt, is that the legislative and executive branches of our government have been keenly aware that, from the very nature of social insurance, and because of the dynamic character of our society and our economy, constant vigilance is necessary to keep the program sound.

This in turn is doubtless the reason for the statutory provision for a periodic review of the status of the trust funds in relation to the long-term commitments of the program by an Advisory Council on Social Security Financing. The major finding of the Council, which reported in 1959 was:

"The method of financing the old-age, survivors, and disability insurance program is sound, and, based on the best estimates available, the contribution schedule now in the law makes adequate provision for meeting both short-range and long-range costs."

The social security amendments of 1960 provide that the next council will be appointed in 1963, with its scope broadened to take in all other aspects of the program besides financing.

[4] This feature of our social insurance provisions was the subject of the following recommendations by the Advisory Council on Social Security Financing:

"The investment of the trust funds should continue to be restricted to interest-bearing obligations of the United States government or to obligations guaranteed as to principal and interest by the United States."

In discussing this recommendation the Council stated:

"Departure from this principle would put trust fund operations into direct involvement in the operation of the private economy or the affairs of State and local governments. Investment in private business corporations could have unfortunate consequences for the Social Security system—both financial and political, and would constitute an unnecessary interference with our free enterprise economy. Similarly, investment in the securities of State and local governments would unnecessarily involve the trust funds in affairs which are entirely apart from the Social Security system."

[5] Sound financing of social insurance requires that over the indefinite future prospective income be sufficient to offset prospective outgo. As far as can be foreseen at any time, such income and outgo should be in what may be termed "actuarial balance."

In our FOASI plan, *income* is limited to contributions (employee, employer, and

those principles. This applies especially to the criteria for the benefit formula, the maximum annual earnings on which contributions and benefits are based, the integrity of the financing, and keeping the plan free of extraneous objectives (e.g., furnishing service benefits) that would confuse its principles and complicate its administration.

As much as I would like to do so, time limitations prevent me from discussing in more detail each of the above characteristics. However, I would like to spend a few minutes on the one listed as "level of protection limited by its basic purpose of social adequacy."

Benefit level.—While the benefit formulas and retirement-age provisions differ basically in the governmental plans being discussed this morning, they can be considered as alternative methods for determining a minimum level of protection. Each has its advantages and disadvantages. The decision as to which approach to follow is one to be determined on practical, rather than theoretical, considerations.

A major practical consideration that is often overlooked is the constitutional and legislative processes of the country. To illustrate, what are the roles of executive and legislative branches of the government? How are proposals for legislation made, and by whom? How does the legislature (or parliament) function? For example, the fact that old age insurance legislation in the United States is handled by the House Ways and Means and the Senate Finance committees—which are the committees responsible for tax and revenue measures—has been a very important influence in having proposals receive thorough scrutiny, with realistic price tags put on them.

It is my feeling that any judgment as to an appropriate benefit level

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self-employed) and interest on the contingency reserve. Public subsidy is excluded. Outgo includes administrative costs as well as benefit payments. Adoption of self-support through contributions and interest as an objective of the plan constitutes a valuable discipline, which fosters adherence to sound principles and avoids unsound change.

Since social insurance must include and retain all individuals covered by law, its forecasting is based on what has been called the "open-group" method. This makes various estimates for many decades relating to those who will be covered in the future as well as to those covered at the starting date of the forecast.

Private insurance in contrast usually adopts a "closed-group" technique which considers only those covered as of such date. Such a closed group is usually well circumscribed by initial selection, by limiting liabilities, or by terminating coverage on failure to observe such basic conditions as paying the premium on time.

Because of the dynamic nature of the economy and the uncertainties of open-group forecasting, the question of whether or not a long-range social insurance plan is in "actuarial balance" with an adequate schedule of contributions is a complex one calling for regular periodic review. This is provided for in the Social Security Act.

must be a pragmatic one on which reasonable men may differ. The benefit formula should be reviewed periodically and adjusted, when necessary, to the basic floor-of-protection goal to take into account changes in wage levels and the cost and standard of living.

Concern has been expressed because average old age benefits under the United States plan have been greatly increased during the last two decades. However, taking into account the changes during that period in wage levels and other relative factors, I am not unduly disturbed by the increases in the benefit levels.

During the period 1940–61, average monthly wages increased from about $115 to about $400, about three and a half times, as compared with three and a third times for the average monthly primary old age benefits—while the cost of living, as measured by the Consumer Price Index, little more than doubled over the same period. It should also be noted that part of the rise in average benefits resulted from a major improvement in the benefit formula which resulted in the payment of relatively larger benefits to persons retiring in the early years of the system.

The foregoing comparison can be taken only as a rough guide as to the nature of changes; other relationships may also be used as tests. Moreover, the increases during the last ten years indicate that the average benefits increased somewhat faster than the wage levels and much more than the Consumer Price Index. It is, of course, too soon to say whether this indicates a definite change in long-term trend or is the result of fluctuations to be expected in any such data. It does point to the need for careful and thorough review of any future proposals for changes in the benefit formulas and in maximum annual earnings covered under the plan.

I am optimistic that, if and when an increase in the dollar benefit or maximum earnings level is again desirable, Congress will compromise reasonably between conflicting points of view, as it has done before. There are at least four reasons for that optimism:

1. The House Ways and Means and Senate Finance committees have responsibility for our federal old age insurance plan.
2. These committees now have available a wealth of pertinent information to aid them in weighing the pros and cons of specific proposals and in placing realistic price tags on them.
3. It has become customary to have the cost of increased benefits covered, when necessary, by suitable adjustment of the payroll and self-employed social security taxes and to either increase taxes when necessary to cover the cost or to scale down the proposed increases so that the cost can be covered by the current tax schedules without increase.
4. There is now statutory provision for a periodic review of the financing and other aspects of the federal old-age insurance plan by a well-balanced advisory council.

I can testify from personal knowledge that past advisory councils dealing with this program have functioned effectively, and their recommendations have been very influential in the adoption of improvements or the rejection of ill-advised proposals. I am confident that future advisory councils will carry on in this tradition.

Financing.—The following extracts from the material prepared for the Advisory Council on Social Security Financing and later published,[6] are an excellent commentary on the method of financing:

> The essential security of this plan rests, in the final analysis, upon the taxing power of the United States Government and the willingness of the people to have it exercised. Hence, it has been recognized that the degree of reserve financing desirable for the old age social insurance plan depends primarily on practical considerations peculiar to that plan, and not on the actuarial considerations often used for private pension plans.
>
> The financing method has functioned satisfactorily to date because the legislative and executive branches of our government have been keenly aware that, from the very nature of social insurance, and because of the dynamic character of our society and our economy, constant vigilance is necessary to keep the program sound.
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> Summing up, the present method of limited reserve financing, which is a blend of pay-as-you-go and full reserve, would appear to be the most appropriate and practical for the Old-Age, Survivors, and Disability Insurance system. However, continued successful operation of the plan requires not only annual appraisal of the operating results but also re-examination at regular intervals of the techniques and assumptions for the long-range estimates. Such periodic re-examinations should be made by both the Board of Trustees and Advisory Councils authorized by Congress.

II. DISABILITY INCOME

Closely allied to the retirement income benefits in the social insurance program of the United States are the long-term disability benefits now included in the federal plan. A disability income benefit on a limited basis was introduced in 1956 and was liberalized in 1958 and 1960. Under the present provisions a person with the required social security credits who has been disabled, under a very strict definition, for at least six months qualifies for monthly disability benefits, and certain members of his family may also be paid monthly benefits. The amounts of these benefits are calculated as though the disabled person were already entitled to old age insurance benefits.

The administration of the disability income benefit differs in one im-

[6] U.S. Department of Health, Education, and Welfare, Social Security Administration—Division of the Actuary, *Methodology Involved in Developing Long-Range Cost Estimates for the Old-Age, Survivors, and Disability Insurance System* (Actuarial Study No. 49 [May, 1959]), Appendix I.

portant aspect from that of the retirement income benefit. This is that the determination of disability is made the primary responsibility of state agencies through contract with the federal government. As a financial control in the administration of this benefit, a separate trust fund—to be self-supporting—was set up to receive the additional tax imposed upon earnings. Out of this fund benefits and a proper share of administrative costs are paid.

With the liberalizations in the program, the number of disability beneficiaries has grown rapidly. Chronic and progressive conditions are most prominent among the causes of disability, the list being headed by arteriosclerotic heart disease and cancer.

The federal plan does not include income benefits for short-term disability. Such benefits are provided to workers under the laws of four states—Rhode Island, California, New Jersey, and New York. There are important differences in these state plans. That of Rhode Island is monopolistic. In California and New Jersey an employer may "contract out" of the state plan and continue or adopt an insured or self-insured plan.

The New York law requires a covered employer to have a plan for his employees, which may be insured or self-insured. In addition, the long-established New York State Insurance Fund for Workmen's Compensation Insurance was authorized to issue insurance qualifying under the Disability Benefits Law. However, this fund operates in effect like a mutual insurance company and hence is not comparable to the insurance plans of the other three states.

The disability benefit formula is about the same as that for unemployment insurance in New Jersey and Rhode Island but differs somewhat in California and is entirely different in New York. New York State places the responsibility for administration of its Disability Benefits Law on its Workmen's Compensation Board, while the other three states have their programs administered in co-ordination with their state unemployment insurance programs.

No states have legislated for temporary disability income since New York acted in 1949. Meanwhile, the number of people covered for loss of income by insurance companies increased by almost 50 per cent—to about 32 million at the end of 1961. Over the same period, the number protected by formal, paid sick plans, but without insurance company coverage, also rose to about 11 million, making the total covered about 43 million. This excludes an unknown number benefiting from informal arrangements.

It was not until recently that I became fully aware of how the extent of voluntary coverage had importantly influenced decisions taken on social insurance matters in the United States. It is the *extent* of voluntary coverage in force, rather than the mere *availability* of such coverage, that

has often, if not always, determined how our legislative bodies (federal and state) decide on new proposals. Stated another way, as a broad proposition, it is only when vacuums in private coverage exist that advocates of social insurance can (and perhaps should) make headway in extending this type of protection.

Whatever the reason, there has been and still is little private insurance coverage in the United States for total and permanent disability. Hence advocates of the social insurance approach were able to persuade Congress that here was a great vacuum which could and should be filled. On the other hand, temporary disability insurance has had an amazing growth, mainly with insurance companies, and it is this more than any other reason that accounts for the almost complete lack of success of advocates of compulsory federal or state government plans in this area.

III. UNEMPLOYMENT INSURANCE

We have seen that the retirement income benefits in the social insurance program of the United States are entirely a federal responsibility and that the permanent income disability benefit is almost wholly so. However, except for the separate federal program for railroad employees, the design and administration of unemployment insurance (often called "unemployment compensation") for covered private employment is left largely to the individual states.

To induce all states to adopt unemployment insurance plans, the Social Security Act levied a payroll tax on covered employers, allowing, however, a credit up to 90 per cent of this tax for contributions made by the employer under an "approved" state plan. Because merit or experience rating[7] is permitted for state plans and employer savings resulting therefrom are also considered as an offset to the federal tax, the total actual state and reduced federal taxes can be substantially less than would be the case without rate reductions by the states.

Some of the taxes actually collected by the federal government are used for its expenses in connection with the state plans. The balance is used to—(*a*) help states meet administrative costs of their plans; (*b*) build a loan fund for advances to states which incur excessive benefit disbursements; and (*c*) distribute any remainder to the states as additional funds primarily for benefit purposes.

While the benefit formulas and qualifying conditions vary widely among states, they are based on the classical social insurance theory of limited payment of unemployment benefits for workers capable of and

[7] A major reason for permitting experience rating in state unemployment insurance plans was probably the precedent in state Workmen's Compensation Insurance laws (see panel discussion on unemployment insurance [*TSA*, V, 334–35]).

available for work who can demonstrate sufficient attachment to the labor market.

Many interrelated issues arise in viewing the financial problems of unemployment compensation, primarily with regard to the level and duration of benefits, the conditions for eligibility, experience rating, and the taxable earnings base. Each of these features in the financing of unemployment compensation is open to considerable discussion, which must necessarily take into account long-range as well as short-range movements in our economic and social structure.

On occasion proposals are made to prescribe a national standard for benefits, the latest being a bill introduced last year. Moves in this direction are usually considered to impinge upon the freedom of action of the states and to constitute a large step toward ultimate federal control.

In view of the then many unemployed who had exhausted their benefits, the federal government in 1958 and again in 1961 made provision to extend the duration of benefits under the state plans for a limited period. These were undertaken as temporary recession measures to run for one year. A proposal to continue the 1961 act was rejected by the House Ways and Means Committee in August of this year.

The recently enacted Trade Expansion Act includes provisions for "trade adjustment assistance" to industries and workers adversely affected by tariff cuts. Workers unemployed by reason of import competition will be entitled to weekly cash payments for amounts and durations well in excess of the benefits available under regular state unemployment compensation plans. The financing is from federal general revenues and entirely independent of that for the state plans. Whether or not these new federal benefits will be a step toward federalization of state plans is a moot question.

Several years ago collective bargaining in the automobile, steel, and other industries resulted in adoption of supplemental unemployment benefit plans under which the employer would provide additional payments beyond the state unemployment insurance benefits. This development, however, did not become widespread in other fields.

Unemployment insurance is a fascinating challenge to actuaries—particularly those active in group insurance—to apply their talents. This was brought out in the panel discussion in 1953 reported in *TSA*, V, 319–35. Four of our members who have been advisers in unemployment insurance matters gave an account of what they did—"case-history" illustrations of what can be done in the way of actuarial service in legislative and administrative matters. The unemployment insurance financial problems for a number of states today are such that there is an even greater need for the advice and counsel of actuaries.

Source of funds for United States social insurance.—The federal Old-Age, Survivors, and Disability Insurance Plan is financed by earmarked taxes paid by employers, employees, and self-employed. The four basic state temporary disability plans are financed by contributions from employees only or employee and employer. The state unemployment insurance plans are financed by employer contributions only, except for three which also collect employee contributions.

The absence of financing from general revenues of the government for any of the United States social insurance plans is, of course, a major difference from general practice in other countries.

Social insurance benefits and the income tax.—If time permitted, a host of issues could be discussed under this heading which should be borne in mind in any broad study of social insurance.

Outside the realm of social insurance, the United States uses its income-tax structure in still other ways for the income maintenance of the aged. Thus, persons 65 and over receive a double exemption from income tax; they also have available a retirement credit; and substantially all their medical expenses are deductible.

Assistance.—This is another subject that must be kept in mind. There now appears to be widespread acceptance of the basic design of the old age insurance plan, despite disagreement over some features. On the other hand, there is now widespread dissatisfaction with the various federal-state programs providing assistance for various categories of persons in need.

For example, it had been expected that the old age assistance program would be a stop-gap arrangement, the need for which would shrink with the maturing of the insurance plan. However, the original expectation that old age assistance was a matter which a state could eventually handle without recourse to federal aid has not been realized. Quite the opposite has occurred. The availability of federal matching funds had unlooked-for consequences in a number of states, owing in no small part to unwise modifications in the original straight 50-50 matching formula for federal grants to states. This and other developments have long indicated a great need for a thorough overhaul of the federal-state assistance program. But until recently critics were "crying in the wilderness." It is encouraging that at long last there is real public and official concern and that assistance problems are being subjected to thorough study by several different groups—including at least one state special investigating commission. However, as much as I would like to do so, I would not venture to forecast that a major overhaul will be the outcome.