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WHEN OLD AGE COMES— DR. X's COCKTAIL

by Arthur Pedoe

One satisfactory trend of modern society of major interest to actuaries is the reduction in the rate of mortality. This reduction is still continung for female lives even to the limit of life; it is questionable whether at the oldest ages male mortality is still reducing.

Of major social significance in this trend is the increasing proportion of older people. In this article, "old" and "aged" mean those age 65 and over. In the United States there are 20 million people age 65 and over, almost 10 per cent of the population; in Canada about 8 per cent, and in France, 13 per cent, the highest of any country. Both numbers and ratios have been increasing, bringing the problem of old people to the forefront. The lower mortality of female lives compared to males means that a greater proportion of old people are women. In the U.S., 11.2 per cent of female lives are 65 and over as against 8.5 per cent of males.

Another aspect is the increase in the number of dependents; those under 20 and those age 65 and over. In both the U.S. and Canada they now exceed 45 per cent of the population and are near the 50 per cent mark—half the population! Many primitive peoples, when faced with this problem, opted for getting rid of the old. It was an American, Nascher, who is held to be the father of the study of the aged which he called *geriatrics*. Actuaries are aware of the exponential increase in disability at the older ages. Government health services are now realizing this fact through bitter experience and are attempting to cope with it.

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C.B.H.W.

After the fashion of the tabloids, this note might have been headed "Barry Will Not Tarry." The members of the Society have already been advised that Charles B. H. Watson, who needs no identification, will return to private practice at the close of the annual meeting.

It is related elsewhere that Adam had a bad time of it because there were no precedents. Barry Watson may have experienced similar feelings in taking over the post of Executive Director. He has, however, successfully established a precedent in a way that has redounded to his credit and enured to the benefit of the Society. Many are the members, both individually and on committees, who are grateful for his help in time of trouble.

Fortunately this is a case not of "Hail and Farewell" but of "Farewell and Hail," since he will surely be seen at future meetings of the Society taking an active part. And so we wish him well in his new position and thank him for the fine job he did as Executive Director.

A.C.W.

AB INITIO

J. Douglas Brown, *An American Philosophy of Social Security*, Princeton University Press, 1972, pp. 244, $8.50.

by E. H. Wells

The author is former Dean, and first Provost of Princeton. His views on Social Security obviously carry weight because he has been a member of all five of the Advisory Councils, since the first Council of 1937, of which he was Chairman. This Council consisted of 25 members, of whom 6 represented labor, 6 were employer members, and 13 represented the public, most of these being associated with universities. One of the employer members was an actuary, M. Albert Lin-

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REFLECTIONS ON FEDERAL INCOME "PHASE 3" TAX

by Clayton A. Cardinal

The "Phase 3" tax is the description given to the federal income tax imputable to amounts withdrawn from the Policyholders Surplus Account maintained under the federal income tax law. This article discusses certain facets of the federal income "Phase 3" tax as it relates to these withdrawals.

The federal tax law provides that stock life insurers establish two separate accounts—a Shareholders Surplus Account (SSA) and a Policyholders Surplus Account (PSA). The SSA can be thought of as holding the insurer's already taxed or tax-exempt earnings, while the PSA contains earnings still to be taxed. Only post-1958 results are used in establishing each of these accounts.

Cash dividends are taken from the SSA, and if the SSA is exhausted the excess is obtained by transferring the necessary funds to the SSA from the PSA. Since no federal income tax has been previously paid on amounts in the PSA, it is necessary to withdraw $100 for each $52 of dividends. The $48 difference represents the "Phase 3" federal income tax. If the distribution to shareholders in a year exhausts both the SSA and PSA, the excess is considered to be paid from the "other accounts" which represent the surplus outstanding at the time the tax law was changed in 1958. No tax is imposed on a company with respect to disbursements imputable to these "other accounts."

A life insurer in a shareholder equity transaction, without knowing its SSA and PSA, could subject to taxation a lot of capital by an involuntary transfer of funds from the PSA to the SSA. The amount of any contemplated disburse-

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Public Relations Committee

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The Committee has written many articles, provided assistance to authors, and handled numerous requests of a public relations nature which have been made to the Society.

Many of our activities involve liaison with other groups, sometimes to coordinate activities and at other times to join forces in a common effort. Continuing liaison is maintained with other public relations groups: the American Academy of Actuaries, the Canadian Institute of Actuaries, the Casualty Actuarial Society, and the Conference of Actuaries in Public Practice.

These groups have joined us in joint development of the Speaker's Kit for the benefit of the entire profession. Our college and high school area chairmen rely heavily on the assistance of local actuarial clubs in obtaining volunteers and in arranging Career Days. Efforts are under way to establish a continuing liaison with the clubs on all activities. Liaison is also maintained with the Education and Examination Committee, the Press Committee, and with the Mathematical Association of America.

Committee members generally serve for three or four years. However, many actuaries will serve for quite a few years in working with a particular college, or simply as volunteers for activities outside of formal Committee membership.

The success of any public relations activity depends on the contributions of many actuaries at all levels. Associates with the time and interest are equally welcome, and all actuaries are encouraged to volunteer for any one of the several entry-ways into this work. We particularly want the participation of the younger members, because our activities must relate to students and to the Society of Actuaries as it will be in the future. These activities contribute to the well being of our profession and make a fine business experience for the individual actuary as well. Experience is gained in meeting a variety of publics, in getting ideas across, and in accomplishing results through a variety of often complicated paths.

We hope that each member of the Society considers it part of his professional duty to be alert to every chance to build a stronger public image. □

Ab Initio

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ton, then President of the Provident Mutual Life.

The genesis of Social Security in America occurred in the depth of the Depression, 1934-35. The original emphasis was on unemployment, and resulted in a "shot gun" marriage of the federal government setting forth standards of coverage, and the states establishing plans to meet these standards in order to get federal subsidy. Thereupon the emphasis became poverty prevention for the aged, then a hot political issue, with flames fanned by the Townsend Plan agitation.

The original concerns in planning for OASI as a national, compulsory, and contributory plan, providing benefits as a matter of right, were its constitutionality, state plans vs. federal, the proposal to permit contracting out, and the financing basis pay-as-you-go vs. full reserves. Fortunately all the right decisions were made. The Social Security Act was passed in 1935, with the first pensions scheduled for payment in 1942. In May 1937, just after the Supreme Court ruled favorably on the constitutionality of the Act, the first Advisory Council was convened on an official, but ad hoc basis, to study the scope and benefit structure and related questions. Starting in 1940, there was a liberalizing of the benefit structure, together with the inclusion of pensions for wives, widows, and surviving children. All this was a fundamental departure in favor of social need from the individual equity concept of a death benefit consisting of the refund of tax contributions.

This departure from private insurance concepts has become an integral part of all subsequent Social Security planning. It is the "American Philosophy" about which the book is concerned. Other distinguishing characteristics of the American system are: (1) the provision for graduated contributions and benefits, rather than a flat benefit for everybody; (2) the financing on a 50-50 basis by employees and employers, without specific governmental contributions; (3) benefits based upon average annual earnings, up to a stated maximum without regard to the number of years of service, and; (4) contributory old-age insurance forming a middle layer between relief or assistance on a needs-test basis, and an upper layer provided by private mechanisms. The benefits under the implied Social Contract are not simply proportionate to contributions, but are weighted in favor of lower paid employees. This weighting can go too far, by lowering the eligibility requirements, or by incorporating relief payments and thereby making them ever-afterwards contractual. On the other hand, the contributory financing feature has served as a brake on unsound enrichment of benefits undertaken perhaps for political expediency.

The author devotes considerable space to the cautious approach to total and permanent disability income benefits and the administrative safeguards. There are also the work rules affecting retired beneficiaries, where the social concept of need comes into play, modifying what otherwise might be the automatic payment of benefits.

The plot gets exciting when the author airs his views on Medicare which, through the accidental overplay of its hand by the American Medical Association, has been divided into Parts A and B. The power of an obdurate and entrenched minority to hold back progress of the vast majority of a people, is said to characterize the A.M.A. The author suggests that it was selfish mercenary reasons which induced the A.M.A. to attempt to defeat the social objectives of health care for the aged.

The book points out that political activity in support of compulsory health insurance began in 1912 under Theodore Roosevelt, originally with concurrence of the A.M.A. Later the A.M.A. proclaimed the evils of "socialized medicine", and perpetuated non-competitive Victorian horse-and-buggy medical practice with its lucrative "piece-rate" *ex parte* determination of fees and the need for hospitalization, consultants, and other services.

The purchaser of medical services, says Dr. Brown, embarks upon the procedure of putting himself into the hands of 2nd, 3rd, and many other persons, without mutual responsibility on their part for total costs. It is as if the buyer of a car, after driving it home, received a succession of bills from the maker of the engine, the body, the wheels, and other parts, at prices they saw fit to

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FOOL'S PROFITS

by Barnard H. Bissinger

With the giveaway in full force garnished by plums such as the lowering of the excise taxes to shoot adrenalin into the heart of our economy, we wonder if the economic advisors will really succeed in getting for the country the long range success by giving the individual the immediate gain. Our wonder grows because of equally deep-seated economic theories that assure healthier gain, have a similar public appeal, but are not being used.

John Stuart Mill may have been the first one to point out that double taxation of the kind now imposed on savings by virtue of later taxing the income from the savings can work extensive destruction upon savings and spendings. The paradoxes that arise are sufficiently interesting in themselves to be told to the people who just might in turn begin an advisory campaign to our mortarboards now advising our government.

As recently as 1941 the eminent Irving Fisher expounded several frightening facts about government taxation of an individual's savings. He not only gave expertly the backfiring destructive effects but supported them with mathematics that would do honor to some of our present armchair solons.

Fundamental to derived defects, he said, was the serious effect of taxing capital-increase. A tax, levied yearly, will reduce the capital formation during a period of years more than will a tax levied at the same rate on the accumulated savings at the end of the period for a sufficiently long period of years. He gave an example of an initial capital of $1000 that has a growth rate of 40 per cent each year. If the yearly tax-rate on the yearly increase be 20 per cent, the initial investment would grow in 40 years to a sizeable amount, $66,500,000. But if it be left untaxed, it would become the stupendous $700,500,000. The imposed 20 per cent annual tax stunted the growth by over 90 per cent!

The first impression now may be "Who needs 700 million when they can have 66 million?" Another retort might be "Isn't it better it went to Uncle Sam?" That's just it, it didn't. Both parties took a licking. For the $634,000,000 lost by the taxpayer is much greater than what Uncle Sam gained in revenue, namely, a paltry $16,000,000. If the government had invested its annual tax bite at 5 per cent compound interest, it still would realize at the end of 40 years only $20,700,000, and the taxpayer still has lost the $634,000,000, the point here being the taxpayer loses considerably more than the government gains.

Now suppose the government has a final tax at death at the same rate. This gives our state 20 per cent of the $66,500,000, or $13,300,000. So the total gain is $30,000,000 and the taxpayer still records the $634,000,000 loss. If the government's 5 per cent interest prevails, the total gain is only $34,000,000. As if this isn't bad enough, we hasten to point out that less revenue is gotten from yearly taxes on capital-increase during life than from taxes at the same rate at death. In our numerical example the 20 per cent tax at death would be $140,100,000, to say nothing of other rewarding virtues. So we see one glaring loss to government of the difference between $140,100,000 and $20,700,000. Even if you add the death-tax to the life-tax, the loss in revenue is still $110,700,000. And once again bringing in the interest rate of 5 per cent, the loss maintains in excess of one million dollars.

Fisher used to say "to put *any* tax on savings is a penny-wise-pound-foolish policy, even from the narrowest fiscal point of view." Better should we reduce the tax all the way to zero. In our example this would give Uncle Sam a nice tidy 20 per cent of $700,500,000! The loss to our nation of $634,000,000 is not just that alone. This loss of earned increment might possibly represent that much capital equipment which in turn benefits labor and the general public.

So far we have said nothing of the psychological effect on people, the discouragement of saving. Obviously this makes matters worse! Hence we have less growth to insure at a later date larger spending on which a tax is healthy for all concerned.

What have we done? We have done away with an appreciable amount of revenue due to taxes on spending, a pedestrian political fanfare at best and only shortly after we had put the tax on savings. One of these moves is bad enough, but the ensemble is catastrophic. There's an old Dutch saying, "It ain't what you eat what gets you the ulcers, it's what eats you." This just might help us Americans straighten out our DIET! □

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Ab Initio

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charge regardless of combined cost to the purchaser, his ability to pay, or any contributory norm.

It is a serious handicap to the activities of the Social Security Administration in rationalizing American hospital administration that they must limit their direct concern to the aged alone. This Dr. Brown thinks is a case of raising the level of a bed by lifting one of its legs. However, the person in the bed—the hospital management—has begun to realize that something is going on.

The intent of Medicare to provide a service benefit rather than an indemnity has, however, been frustrated to a marked degree by the unwillingness of American physicians to accept payment of Part B charges as determined under Medicare guidelines. Help in determining the proper levels under a variety of circumstances may be computerized.

The book winds up with a chapter on Health Care—the expanding frontier of Social Security—pointing out that we have only begun to take care of the needs of the population for basic protection.

The book is well organized and, although much of it may be well known to many actuaries, it is unquestionably worth reading. □

Actuarial Club Meetings

Nov. 15, Actuaries' Club of Des Moines

Nov. 20, Chicago Actuarial Club

Nov. 21, Actuaries Club of Philadelphia

Nov. 30, Nebraska Actuaries Club