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MISCONCEPTIONS AND MISSING PERCEPTIONS OF OUR SOCIAL SECURITY SYSTEM (ACTUARIAL ANESTHESIA)

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Experience teaches us to be most on our guard to protect liberty when the government's purposes are beneficent.

BRANDEIS—*Olmstead v. United States*, 1928.

INTRODUCTION

THE Report of the Advisory Council on Social Security Financing stimulated the observations in this paper which aim to look beyond the Council's terms of reference as limited by statute and its interpretation of its responsibilities.

The actuaries of the Social Security Administration and the U.S. Railroad Retirement Board have done skillful professional work in the public interest by furnishing reliable benchmarks to test the actuarial equivalence of contributions and benefits under the Social Security and Railroad Retirement Acts. It is no criticism of their activities to suggest that all actuaries have a responsibility to make clear to the public the limitations of the significance of actuarial calculations. Actuarial equations cannot measure the contributor's willingness and capacity to pay. They cannot measure the soundness of the principles of equity between individuals and generations, the readiness of individuals to accept such principles, nor the extent of their understanding. Actuarial balance sheets cannot assure good housekeeping by government in funding retirement programs; they do not reveal the broad social and economic effect of compulsory programs; they cannot control the extent of the obligations one generation places upon another. Actuaries should be the first to warn that actuarial balance, while a *necessary* condition, is not a *sufficient* condition. The work of the actuary must not become a soothing agent that unduly quiets a legitimate concern as to the truly successful operation of programs established by one generation which will have powerful effects upon future generations.

Over 20 years ago, there were scholarly debates by actuaries on social insurance financing which are well worth rereading at this time. Those debates between the "reservites" and the "current-costites," probing economic and social aspects of financing old-age benefits, constituted a great public service at the time. While the author has no deliberate purpose to revive that debate, he will not be disappointed if the observations here made stimulate a lively and responsible interest among the younger members of the Society of Actuaries.

Jeremy Bentham, a leading intellectual of the early nineteenth century, had considerable to say about the fallacy of irrevocable laws in his *The Book of Fallacies*, published in 1824. Speaking of the sages of a prior generation, he wrote:

> It is their prodigious anxiety for the welfare of their posterity that produces the propensity of these sages to tie up the hands of this same posterity forevermore—to act as guardians to its perpetual and incurable weakness, and take its conduct forever out of its own hands.
>
> If it be right that the conduct of the nineteenth century should be determined not by its own judgment but by that of the eighteenth, it will be equally right that the conduct of the twentieth century should be determined not by its own judgment but by that of the nineteenth. And if the same principle were still pursued, what at length would be the consequence?—that in process of time the practice of legislation would be at an end. The conduct and fate of all men would be determined by those who neither knew nor cared anything about the matter; and the aggregate body of the living would remain forever in subjection to an inexorable tyranny, exercised as it were by the aggregate body of the Dead.

There is probably no other legislative enactment that commits future generations to greater obligations than our Social Security Act. Although Section 1104 of the Act makes changes possible, only a major economic crisis would justify a reduction of benefits in the minds of the people, particularly the millions of pension recipients. As a matter of good faith, there is no question but that the benefits promised are intended to be permanent and assured. Some years after the enactment of the original Social Security Act, Franklin D. Roosevelt supported the contributory principle in these words:

> We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my social security program.[1]

The author's purpose is to (1) try to attain a greater insight into the nature and significance of the social security financing method, and, to that end, determine whether the operations of the railroad retirement system give us any clues as to what we may expect in the future under the social security financing method, (2) examine the image in the public mind of the social security financing method and its significance, (3)

[1] Schlesinger, *The Coming of the New Deal*, p. 308.

identify some questions as to the social and economic impact of the social security financing method, (4) examine the income tax treatment of social security contributions and benefits, and finally, (5) set down some conclusions.

The author wishes to acknowledge at the outset the indispensable value to this discussion of the voluminous actuarial literature produced by the actuaries of the social security and railroad retirement systems.

NATURE OF SOCIAL SECURITY FINANCING METHOD

The evolution of the principles underlying OASDI financing is described in *Actuarial Study No. 49*, Appendix I.[2] Briefly, the financial mechanics are: the *primary* source of the money for *current* benefit payments is the *current* contributions from employees, employers and the self-employed; a fund of "modest" amount is developed which arises from any excess of current contributions over current benefit payments; this fund permits a contribution schedule which progresses in an orderly known amount, acts as a buffer for variations in contributions and benefit outlays, and provides a modest current income source from interest earnings.

Although this system has been termed a "limited reserve" or "modified pay-as-you-go" system, no single technical term for it has been found. Economists usually include social security benefits with what they call "transfer payments." This suggests that since, for the most part, current contributions are merely transferred to current payees, the "transfer method of financing" would be a good descriptive phrase.

In describing the evolution of the financing method, we read in Appendix I of *Actuarial Study No. 49:*

> As is often the case in this country, the answer was arrived at through a pragmatic political process rather than a theoretical philosophical process. And, as is also often the case, the pragmatic process has resulted in an answer which has, to date at least, worked out satisfactorily. Just as the benefit formula is a blend of equity and adequacy, with much greater emphasis on the latter, so is the financing method a blend of "reserve" and "pay-as-you-go," with the latter having the greater weight. Both of these blends, with the weight shifted to "adequacy" and "pay-as-you-go" respectively, were inherent in the 1939 Amendments and have met the very severe tests to which they have been subjected in the unprecedented conditions of the last 20 years.

Is there danger that we are overoptimistic as to the success of the financing method to date? It has been operating during a period when the sys-

[2] *Methodology Involved in Developing Long-Range Cost Estimates for the Old-Age, Survivors, and Disability Insurance Program*, Social Security Administration, Division of the Actuary, May, 1959.

tem was immature and the contributions modest—when the actuarial or money value of the benefit to a recipient has been many times the amount of contributions made with respect to the recipient.

Has the blend been so bland as to blind us to blunders?

What is the extent of the blend of adequacy and equity? Some idea may be gained from a cost analysis of the OASDI system (as it was before the 1958 amendments) for present members and new entrants appearing in *Actuarial Study No. 48.*[3] We read:

> The level-premium cost, after allowing for the existing fund, is 16.10% for present members as compared with 4.93% for new entrants (the latter figure is the normal cost). The sum of the present value of the contributions to be paid under the present schedule by present members and the existing fund is $269 billion less than the present value of benefits to be paid to them and their dependents and survivors; . . . On the other hand, there is a "surplus" of $228 billion for new entrants.

The level-premium equivalent of the present value of contributions with respect to present members, as given in the *Study*, is 6.74% of payroll compared with 16.10% of payroll—the value of benefits. In decided contrast, the level-premium equivalent of the contributions with respect to new entrants is 8.30% of payroll compared with 4.93% as the value of benefits. Present members and their employers, as a class, pay only about 42% of the value of their benefits, whereas new entrants and their employers will pay 169% of the value of their benefits. The equivalent level contributions of 4.15% for employee new entrants pays over 84% of the cost of their benefits. It is worse for the self-employed new entrants. Their equivalent level contribution is 6.23% of payroll or 125% of value of benefits. In this connection, it is important to recognize that, as employee unions have bargained for welfare and pension benefits, they have come increasingly to maintain that the employer contribution is in lieu of wages, that the contribution for pensions is a deferred wage and as a result the line between employee and employer contributions becomes less well defined. Hence, new entrants to the system may come to look upon the total of 8.30% as a cost to them for which a 4.93% value is obtained.

What is the extent of the blend of "pay-as-you-go" and "full reserve"? During the next decade, when the OASDI Trust Fund may be from two to three times the annual rate of benefit payments, the interest on the fund will be 6% to 9% of the benefit payments, say an average of 7½%. For a mature "full reserve" system, interest income would be 40% to 45% of pension outlays. It may then be said that the blend is about 5/6 "pay-as-you-go" and 1/6 "full reserve."

[3] *Long-Range Cost Estimates for Old-Age, Survivors, and Disability Insurance under 1956 Amendment*, Social Security Administration, Division of the Actuary, p. 20.

We need to know more about the kind of economic organism that we have created in the social security and railroad retirement systems. Legislation enacted today sets in motion forces which reach far into the future. In order to measure the significance of such forces, we need to appreciate that these retirement programs are *dynamic* economic instrumentalities. They are growing economic organisms. They have built-in features which generate and guide the pattern of growth. We must be able to detect symptoms in their growth behavior which may portend future trouble.

Basic Financing Principles

In a report on the "Seventh Actuarial Valuation of the Railroad Retirement System" by Abraham M. Niessen in the May 1959 *Social Security Bulletin*, he gives this description of the method of financing railroad retirement benefits as well as social security benefits:

> The present method of financing used by the railroad retirement system (as well as by old-age, survivors, and disability insurance) may be described as a kind of frozen initial liability method accompanied by level-premium financing. With an actuarially adequate tax rate, the income to the system would be sufficient to take care of the normal costs—that is, costs computed as of the original ages of entry—and to pay interest on the unfunded accrued liabilities. The unfunded liabilities would thus never be liquidated but would be prevented from growing.

Two basic financing features are common to the railroad retirement system and the social security system. (For purposes of this discussion, the status of "railway employee representatives" and the self-employed is not considered.) These two features are:

1. All benefit outlays are to be covered by employee and employer contributions and investment income from the fund derived from the excess of contributions over benefit payments—in a word, self-supporting.
2. Employer contributions are limited to matching employee contributions—in other words, the employee pays one-half of *total* costs.

Both programs provide benefits, established at the inception or subsequently, for existing pensioners and, in the sense used in pension plans, for past service benefits for active employees. *One-half* of the cost of *all* accrued benefits and future accruals for active employees, as they are at the inception and as they are expanded from time to time, are to be met by the *future contributions* of employees (except for the limited assistance of existing trust funds). In the history of pension plans, has there ever been a plan successfully funded on this basis?

In *Actuarial Study No. 40*,[4] an important social insurance principle is given in these words:

Still another important principle—that of individual equity—is involved in the determination of the contribution schedule. According to this principle, the eventual contributions should not be so high that young entrants could purchase more protection with their own contributions from a private insurance company. This viewpoint has been expressed by many students of social security (including those testifying before congressional committees), but was never set forth in any of the committee reports underlying the 1950 or subsequent legislation.

Symptoms of Trouble

In 1952, the following appeared in the *Report of the Joint Committee on Railroad Retirement Legislation*, (p. 319):

Mr. Murray W. Latimer, former Chairman of the Railroad Retirement Board, and Mr. Russell R. Reagh, until recently a member of the Actuarial Advisory Committee, have taken the position that the danger point would be reached if the scale of benefits indicated a required level of tax rate as high as 160% of the normal rate.

Repeated amendments to the railroad retirement plan have produced the following results which indicate that that system, in a few years, will have gone beyond the danger point cited by Messrs. Latimer and Reagh.

It is significant that, in the legislative committee reports on the 1959 railroad retirement plan legislation, the contribution rate for new entrants

Calendar Years (1)	Entry Age Normal Cost (2)	Total Tax Rate (3)	Ratio of (3) to (2) (4)
1937–39	5.59%	5½%	98.4%
1940–42	5.77	6	104.0
1943–45	5.20	6½	125.0
1946	5.20	7	134.6
1947–48	7.87	11½	146.6
1949–51	7.66	12	156.7
1952–54	7.99	12½	156.4
1955–58	8.39	12½	149.0
1959–61	9.60 (est.)	13½	140.6
1962–64	9.60	14½	151.0
1965	9.60	16	166.7
1966–68	9.60	17	177.1
1969 & after	9.60	18	187.5

[4] *The Financial Principle of Self-Support in the Old-Age and Survivors Insurance System*, Social Security Administration, Division of the Actuary, p. 3.

was not mentioned and there was no evidence of any interest or concern. Also, in the 1205 page record of the social security hearings in June 1958, there is absolutely no evidence of any interest in the social security cost for the average new entrant.

The record of both the railroad retirement and social security systems in the last 20 years, during which there have been repeated amendments improving benefits for all persons, retired and active, warrants the expectation that benefits for existing payees and so-called past service benefits will be increased from time to time in the future in recognition of increased productivity and any effects of inflation. The number of payees, particularly in the case of the social security system, may be expected to increase in relation to the active labor force. Such increased benefits will require increased contributions, one-half of which are to be met by *future employee contributions.* There is no intrinsic reason why the one-half contribution payable by employees cannot become greater than the contribution required to support the benefits for a new entrant. The two features of (*a*) self-support and (*b*) limitation of employer contributions to employee matching have a confining effect which, as evidenced by the railroad retirement plan experience, produces progressive and possibly endless increases in employee contributions as benefits for *all* participants are raised from time to time. The cost pressure of increased benefits finds its release in the employee contribution rate. Is this sound? When this rate approaches or exceeds the "entry age normal cost" and there is an awareness of this situation (which employees should be informed of within the spirit of the Federal Welfare and Pension Plan Disclosure Act), resistance to payment will arise from lack of capacity to pay, unwillingness to pay and an outraged sense of fairness. There will truly arise a "din of inequity."

We have already seen resistance to high contributions arise in the case of the railroad retirement plan. Railway workers have been paying at a rate higher than any other industrial employees and the rate is scheduled to go higher. Resistance to payment has been evidenced by the great legislative pressure for making contributions of employees excludable from gross income for income tax purposes. A bill providing for such exclusion was introduced in 1956; a similar one, H.R. 5551, was introduced in the 85th Congress which failed of passage although there was substantial congressional support. In the 86th Congress, H.R. 1898 and 3973 were introduced with the same provision. The very high contribution rate, which rises to 9% in 1969, warrants the expectation that this discriminatory tax legislation will continue to be pressed. We may note, in passing, that under the 1959 amendments to the Railroad Retirement

Act, representatives of employee organizations (presumably labor unions) are required to contribute 18% of earnings by 1969 for benefits that are calculated to be worth about 9.6% of earnings for a new entrant! This is an unconscionable situation.

Despite Mr. Niessen's statement of the principle of a "frozen initial liability" under the railroad retirement system, here is the way the unfunded liability, as the term is used in conventional pension funding, has grown since the inception of the system:

Valuation	Gross Unfunded Liability* (in millions)
Preliminary	$ 1,796
First	3,388
Second	3,615
Third	4,330
Fourth	7,383
Fifth	10,475
Sixth	12,637
Seventh	14,995
1959 Amendments	17,000 (Est.)

* These figures do not take account of the financial interchange with the OASI system, since the only purpose is to show the increase in gross unfunded liability arising from inadequate and delayed legislation, even though some of the liability may be shifted to the OASI system by such financial interchange.

As benefits are successively liberalized, the unfunded liability increases, the entry age normal cost rises, and the interest on the new segment of unfunded liability adds to the required contribution. With the employer limited to matching the employee's contribution, the pressure of increased benefits pushes employee contributions higher and higher.

Symptoms of Growth

What symptoms of further growth do we see in the social security system? The figures in the table on the next page are significant.

If one were to extrapolate into the future from these series, where would it take us? Are they evidences of built-in patterns and forces that we should know about which determine the nature of changes in benefits and contributions made from time to time? Are they indicative of a fundamental momentum of the system? What kind of an economic organism do we have?

The railroad retirement system, with the same features of self-support and limited employer contribution as the social security system, may be considered a microcosm of the latter system. Are the results of growth now evident in the railroad retirement system portents of future similar behavior of the social security system? The entry age normal cost under the

1958 Social Security Amendments has not been published; however, one would expect that the employee contribution rate of 4½% effective in 1969 would be approaching the contribution rate for new entrants. The self-employed rate for 1969 of 6 3/4% may well be close to 150% of the new entrant contribution rate required to support benefits.

The Advisory Council on Social Security Financing recommended that the maximum on earnings taxed and credited towards benefits should be increased from time to time as wages rise.

Wages are expected to rise substantially by reason of increased productivity and inflationary pressures. Professor Clark Kerr, Chancellor

INTERMEDIATE COST SOCIAL SECURITY OUTLAY ESTIMATES*
(In billions)

Calendar Year	1939 Act	1950 Act	1952 Act	1954 Act	1956 Act	1958 Act
1960	$1.77	$ 3.78	$ 5.72	$ 7.28	$ 9.63	$10.52
1980	4.33	7.97	11.12	15.28	20.18	22.25
2000	6.77	11.26	14.82	20.01	28.13	31.32
	Level Premium Equivalent as a Percentage of Taxable Payrolls					
Interest Assumption:	(2%)	(2%)	(2¼%)	(2¼%)	(3%)	(3%)
Level Premium*	4.50%	6.12%	6.69%	7.47%	8.25%	8.76%
Interest Assumption:	....	(3%)	(3%)	(3%)	(3%)	(3%)
Approximate Level Premium	....	5.25%	6.00%	7.00%	8.25%	8.76%

* *Actuarial Studies*, Social Security Administration, Division of the Actuary.

and Professor of Industrial Relations of the University of California, well-known authority on labor economics, has expressed the view that, based on certain fairly reasonable assumptions, workers' annual real income by 1975 will have risen by about 40%, and that there will also be some mildly inflationary potentials.[5]

In the light of this forecast, it seems reasonable to expect very substantial increases in social security benefits in the next twenty years with consequent increases in "unfunded liabilities," required contributions, etc. The present unfunded liability of the railroad retirement system is about 300% of annual taxable payrolls. According to *Actuarial Study No.*

[5] Clark Kerr, "The Prospect for Wages and Hours in 1975," *U.S. Industrial Relations: The Next Twenty Years*, Michigan State University Press, 1958.

48,[6] the "unfunded liability" under the 1956 Social Security Act is $321 billion. The 1958 amendments should make it close to $350 billion or 175% of total annual taxable payrolls of about $200 billion.

We should not become anesthetized by the actuarial balance of the social security contributions and benefits nor by the soothing concept of self-support. We need to understand better the probable *future* behavior of our social security financing method. What *is* the nature of this economic creature which we have produced by a "pragmatic political process"?

Political Environment

The political environment in which our financing system is created may be considered as one of its basic ingredients, and a most significant one. With a sense of resignation, we acknowledge the fact that, in a democracy, decisions to be made by our representatives in government must inevitably be reached by a process of political pulling and hauling and compromise and with an eye to the necessity of being reelected. In considering the role that government should play in providing old-age benefits, it is vitally important that the effect of this political environment be fully appreciated.

Legislation with respect to the Railroad Retirement Plan, the Civil Service Retirement Plan and the Social Security Law is frequently a political football. In the 80th Congress, 39 bills were introduced to amend the Railroad Retirement Plan. In the 81st Congress, there were 103. Nearly all proposals were generous liberalizations. The unfunded liability grew because of delay in increasing contributions. We are all familiar with the great flood of bills introduced each year to amend the Social Security Act and the fact that liberalizations have come regularly in election years since 1950. In the nonelection year of 1959, "128 bills were offered in the first half of this year to liberalize old-age benefits. But most of these bills provide for several amendments."[7]

How good has the government housekeeping been with respect to its two "private" systems, railroad retirement and civil service?

As highly laudable measures, Congress has provided for an independent Actuarial Advisory Committee to the Railroad Retirement Board and an independent Board of Actuaries for the Civil Service Retirement and Disability Fund. Special legislative committees and commissions have been appointed by Congress to make comprehensive fact-finding investigations to help the Congress develop sound plan and financing provisions for these programs. The actuarial boards have furnished excellent advice, and the

[6] *Op. cit.*

[7] *U.S. News & World Report*, July 27, 1959, p. 98.

special legislative committees have provided extensive, valuable background information, but, as to legislative measures, the recommendations and information have been frequently ignored. A few illustrations will suffice.

As to the Railroad Retirement Plan, the Actuarial Advisory Committee has repeatedly warned that the unfunded liability should not be permitted to increase. Referring to the third valuation, made as of December 31, 1944, the Committee stated:

> The committee believes that the railroads and the employees should not lose sight of the fact that until revenues are adjusted so as to hold the unfunded liability at least in check, the future of the system is not on a conservative financial basis.

With respect to the fourth valuation, made as of December 31, 1947, the Committee said:

> Increased benefits for past service cannot be added indefinitely simply by capitalizing them as an additional accrued liability without weakening the financial structure of the retirement system and without an increasing probability that it will not in fact prove self-supporting.
>
> A minimum standard of sound financing applicable to any retirement system, except possibly a national scheme, would seem to be that any initial unamortized liability should at least be held constant.

Reference to figures previously given will show that the gross unfunded liability has increased $10 billion since this warning was made over ten years ago!

The Board of Actuaries of the Civil Service Retirement Plan has been making annual reports for 38 years. In these reports, it has always recommended that employee and government contributions be adequate to support the benefits for new entrants on a level percentage of payroll basis; it recommended for many years that unfunded liabilities be completely funded by 1998, but it now seems to be supporting the "normal cost plus interest" basis; and it has repeatedly criticized, in blunt terms, the Government's failure to meet these actuarial standards. This failure has produced the growth of unfunded liabilities shown on the following page.

The Civil Service Retirement Act was amended in 1956 to provide that "the Commission shall submit estimates of the appropriations necessary to finance the fund on a normal cost plus interest basis and to continue this Act in full force and effect." There was also an amendment which requires each employing agency, beginning July 1, 1957, to match the contributions of its employees. Additional amounts to meet full "normal cost plus interest" must be appropriated directly. In 1958, there was a further amendment which stipulates that no increase in, or new, annuity benefits thereafter enacted by amendment to the Act can become effective until an amount is appropriated to the fund sufficient to prevent an immediate increase in unfunded liability arising from added benefits.

Despite the high purpose implied in the 1956 Amendments, the Bureau of the Budget failed to provide in the fiscal-1959 budget for the direct appropriation required to meet "full normal cost plus interest" (then esti-

Fiscal Year Ending June 30	Unfunded Liabilities* (in millions)
1951	$ 4,875
1952	4,938
1953	9,911
1954	10,805
1955	13,232
1956	17,330
1957	17,950
1958	20,449
1958 (Rev.)†	27,451

* *Annual Reports* of the Board of Actuaries of the Civil Service Retirement System.

† *Special Report*, based on improved actuarial assumptions as to mortality, disability, and retirement rates and more accurate recognition of salary and age and service distribution changes between 1953 and 1958; June 15, 1959.

mated as $589 million[8]); the Congress *did* include such amount in a general appropriation bill, but the entire bill was vetoed solely because of this item. The President's veto message said:

> There is no sound justification whatever for adding unnecessarily over half a billion dollars to a deficit which may reach $12 billion this fiscal year.
>
> If this appropriation had been required to meet a current obligation of the Government, I would have requested it. However $8 billion is now on hand in the fund. Receipts of the fund will exceed outgo during the current year and for years to come. As provided by the civil service retirement law, the departments and agencies of the Government this year will make direct payments of $645 million to the fund. This amount, matched by employee contributions, plus interest collected on the fund's balance, will provide total receipts of over $1.5 billion to the fund in 1959. On the other hand, payments of claims and refunds this year will total less than $800 million.

The President or his advisors provided the actuarial anesthesia!

There are other evidences of grave misunderstanding in the Congress. When the Special Report of the Board of Actuaries appeared in June 1959, Congressman Glenn Cunningham, a member of the House Post Office and

[8] $915 million, based on *Special Report of the Board of Actuaries on the Valuation of the Civil Service Retirement System as of June 30, 1958;* June 15, 1959.

Civil Service Committee, took violent exception[9] to the reported $27.5 billion deficit. He said that there was unnecessary alarm, that there is not now nor has there ever been a cash deficit (the fund now amounts to $9 billion), that the actuarial deficit was a nebulous thing and that he doubted that anything like $27.5 billion would ever have to be paid, that there is no indication from current figures that the fund is approaching a deficit, that the government is matching employee contributions dollar for dollar, that only about 10 per cent of employees retire, and that the government matching contributions for those who withdraw their deposits remain in the fund. Congressman Cunningham provided his own brand of actuarial anesthesia!

After nearly forty years of trying to explain actuarial funding to Congressmen, the Board of Actuaries must be getting a bit discouraged.

There are three points regarding this retirement system that deserve emphasis.

1. The payment of interest on the unfunded liability has exactly the same financial effect upon current governmental financial operations as the payment of interest on a recognized amount of debt which is equal to the unfunded liability. Indeed, this unfunded liability should be recognized as a part of the national debt by the issuance of bonds to cover it. If this were done, it would be necessary to include the interest requirements in Federal budgets and the financial legerdemain in budget-making which the Administration engaged in for fiscal 1959 could not be practiced. Otherwise, the unfunded amount is likely to increase.
2. If a private retirement plan fails to keep its initial unfunded liability from increasing, Treasury Department regulations are very likely to result in its disqualification. However, as indicated, the government has been violating repeatedly this standard which it has established for private plans.
3. The failure of the government to fund currently the cost of Civil Service Retirement benefits means that it is not requiring current taxpayers to meet current operation costs, and a substantial part is being passed on to future generations of taxpayers. This fact, rarely mentioned, is of fundamental importance.

Points 2 and 3 apply with the same force to the Railroad Retirement Plan, substituting *transportation users* for *taxpayers* in point 3.

How can actuaries convey these truths to government officials who are making the decisions? To the many members of the Society who are familiar with the high degree of advance funding being done by business man-

[9] *Congressional Record*, July 14, 1959, p. 12,171.

agement for private retirement plans, the contrast with this government operation is striking. Experience has demonstrated that pension programs have a far better chance of being soundly conceived and funded under private auspices than in a political environment.

The Test of Social Security Financing Is Still to Come

More questions have been raised here than have been answered regarding the true nature of social security financing. The author hopes he will stimulate others to probe more deeply and to come up with some answers.

This probing of the nature of the social security financing method can be fittingly closed by a statement of a perceptive foreign observer:

> The critical test of the actuarial soundness of the Program is, however, yet to come, since up to the present the contributors who have retired—with minor exceptions—have, together with their employers, or as self-employed persons, paid for much less than the value of the benefits they have received and will receive. This is readily apparent from the fact that by 1969 the tax rates for Old-Age and Survivors Insurance will have to be raised from the combined rate on employees and employers of four per cent in 1958 to 8½ per cent—to provide the benefits contained in the 1958 Amendments. Will the Congress permit these required tax increases to go into effect without from time to time raising the real level of benefits further in the next decade? However justified any such increases may be, one consequence of them will be to require yet further increases in the tax rates or in the upper earnings ceiling or, more probably, in both. Sooner or later voices are likely to be raised in the Congress saying that the burden of contributions for the Program is becoming too heavy for a significant fraction of the self-employed, or for the lower income groups. Some will demand a subsidy from general revenues, others a change in the tax structure to reduce the burden on those with relatively low incomes. When this time comes—perhaps within the next decade or two—the determination of the Congress to keep the Program both actuarially sound and self-supporting will really be put to the test.[10]

IMAGE IN PUBLIC MIND OF METHOD OF SOCIAL SECURITY FINANCING

A study of the *Report of the Advisory Council on Social Security Financing* and the associated *Actuarial Study No. 49* will give the social insurance student an excellent understanding of the method of financing. But what is the image of the method of financing in the public mind? It is far more important that *this* image be accurate than that of a limited number of social insurance experts.

The image of the method of financing in the public mind will be formed in good part by what is read in the newspapers and magazines. Here is how the Report of the Council was presented to the public by some important news channels:

[10] Robert M. Clark, *Economic Security for the Aged in the United States and Canada.*

Time Magazine, January 12, 1959: Pay Now, Buy Later. . . . Is the enormous Social Security fund (current reserves: $22 billion) really secure between the time the wage earner is nibbled and the time he begins to get his payments? Yes, reported a Congress-created advisory council. . . . Their summary: the financing of the Old Age and Survivors' Insurance system is "sound, practical and appropriate."

Newsweek, January 12, 1959: "Sound" and Costlier. The nation's many-billioned Social Security System, often a target of cautious economists, entered a new era last week with a clean bill of financial health from a panel of probers. . . . Surveying the plan, a special thirteen-man advisory commission drawn from industry, labor, and government found it "sound . . . [with] adequate provision for meeting both short-range and long-range costs." While the Social Security System will be in the red through 1959, partly because of wider benefits voted by Congress in 1956 and 1958, the commission estimated it would be in the black by 1960, and would stay there "through 2020 or later" under the current schedule of tax increases.

U.S. News & World Report, January 9, 1959: WHY YOUR OLD-AGE PENSION IS SAFE. You don't need to worry about your old-age pension from Social Security. The money back of it is safely invested, earning a return. That's the verdict of experts who just concluded a thorough review of Social Security. What they found is told here.

A new official report on Social Security offered these findings last week:

Pensions are safe, the old-age insurance system sound.

In years ahead, the trust fund out of which pensions are paid will grow. The recent shrinkage in this fund is temporary, no cause for worry.

Payroll taxes should go up again in 1960, 1963 and 1966, as now scheduled in law. A final 1969 increase, already on the books, might be postponed.

Judging by the following excerpt from an editorial in *The Wall Street Journal*, its editorial staff, as late as January 27, 1959, had little understanding of the method of financing OASDI benefits.

The boost in Social Security taxes on January 1, from $94.50 to $120 (maximum), is just a hint of what is to come. By 1969 the tax will be up to $216, an increase of 80% in the next 10 years. The original law in 1937, incidentally, called for a maximum tax of $30. The Government, it would seem, believes that by 1969 the cost of living will have risen to more than seven times what it was in 1937. . . . The whole Social Security system is now operating in the red.

The headline on the *New York Times* story of January 2, 1959 was "U.S. OLD-AGE FUND DECLARED SOUND."

These statements evidence confusion as to what it means to be "in the red" or "in the black" and also as to the significance and purpose of the "fund." The seeming reliance on a "fund" and the use of the term "insurance" throughout the Social Security Act create a semantic façade which is a barrier rather than a help to general public understanding of the method of financing. The placing of the word "social" before "insurance" wherever it appears in the Act to convey the idea of socialization of costs might help to distinguish the OASDI method of financing from that of private voluntary insurance.

The law itself gives unwarranted emphasis to the "fund" in Section 116(a) of the Social Security Amendments of 1956 which establishes the Advisory Council. The Council was established

> for the purpose of reviewing the status of the Federal Old-Age and Survivors Insurance Trust Fund and of the Federal Disability Insurance Trust Fund in relation to the long-term commitments of the old-age, survivors, and disability insurance program.

Then, parenthetically, Section 116(d) provides for the Council to recommend changes in the tax rates:

> The Council shall make a report of its findings and recommendations (including recommendations for changes in the tax rates in sections 1401, 3101, and 3111 of the Internal Revenue Code of 1954). . . .

The *mainstay* of the financing system, *i.e.*, taxes on earnings of employees, is referred to with the appearance of an afterthought.

There is substantial evidence that the Social Security Administration and other strong supporters of the social security system believe or want to believe that our social security system is very much like private insurance.

In a booklet published by the Social Security Administration, "Your Social Security," Form No. OASI-35, January, 1959, the initial statement reads:

> The basic idea of old-age and survivors insurance under the social security law is a simple one:
>
> *During working years employers, their employees, and self-employed people pay social security taxes which go into special funds and*
>
> *When earnings have stopped because the worker has retired, or died, or is disabled and is* 50 *years of age or over, benefit payments are made from the funds to replace part of the earnings the family has lost.*

Exactly the same statement, substituting "contributions" for "taxes" would be *more* appropriate for a "full reserve" private insurance program!

A recent book, *Know Your Social Security*, by Dr. Arthur Larson projects an image of the social security system which emphasizes the similarities to private insurance and minimizes the differences—a bland selling presentation. He writes:

Social security is a combination of old-age pensions, disability insurance, and life insurance.

The "premium" for this combination of benefits is a payroll tax of 5% on your wages up to $4800 a year. The employer in 1959 pays 2½% of this, and the employee pays the other 2½%. . . .

Social security is based on the same principle as private insurance, with variations to accomplish its social purpose and to keep it inexpensive.

Social security differs in important ways from commercial annuities and private life and disability insurance, but the general idea is the same. This idea is that contributions are made by you (and on your behalf by your employer), in return for which you get certain insured rights, including pensions and death benefits.

He writes that "social security is much like private annuities and life insurance," with three main differences which, summarized, are:

Private Insurance	Social Security
1. Privately handled	Handled by government—hence contribution called a "tax," not a "premium"
2. Benefits directly related to contributions	Three disproportions: (*a*) same as applies to any insurance, (*b*) initial older entrants favored, (*c*) low-wage earners favored over high-wage earners—last "kind of disproportion is the only important one"
3. Legal contract	Conditions of payment "somewhat more limited"

In characterizing the benefit formula, weighted in favor of low-wage earners, as the only important disproportion, he does not believe it significant that the middle-aged and the older members of the present generation get benefits of much greater value than the value of contributions with respect to them and that this subsidy must be paid for by contributions with respect to younger persons and mainly by new entrants, *i.e.*, future generations.

In contrast to Dr. Larson's presentation, Dr. Robert M. Clark, in his report for the Canadian Parliament,[11] gives five points of similarity and ten points of dissimilarity between private and social insurance. They are similar, he says, in that both are based on pooling of definite risks, require the payment of contributions or premiums, provide predetermined benefits not depending upon demonstrated need, benefit society as a whole, and are undermined by inflation.

[11] Robert M. Clark, *Op. cit.*

His points of dissimilarity may be shown concisely as follows:

	Private Insurance	Social Insurance
1.	Voluntary	Compulsory
2.	Equity principle predominant	Adequacy principle predominant—favors initial older persons, women, families over individuals, lower income groups
3.	Individual may pay entire cost	Employer usually contributes as much as employee
4.	Competitive	Government monopoly
5.	Costs readily predictable	Costs difficult to predict
6.	Legally binding contracts	Open to legislative change
7.	Opinion generally uniform as to objectives	Wide differences of opinion as to objectives and methods
8.	Must operate on full reserve basis without reliance on new entrants' contributions	Full reserves not needed because of compulsory contributions from new entrants
9.	Investments mainly in private channels	Investment solely in government bonds
10.	Vulnerable to undermining by inflation	Taxing power more readily can overcome undermining of inflation

As further evidence of efforts to draw a parallel between private insurance and social insurance, we may point to a statement made to Dr. Clark by Robert M. Ball, Deputy Director of the Bureau of Old-Age and Survivors Insurance of the Social Security Administration. In defense of the policy of fixing social security taxes without any initial income bracket exemption, Mr. Ball said: "The argument as used in the United States for such a policy under Old-Age Insurance is that the contributions, though legally a tax, *are a premium* for social insurance benefits." (Emphasis added.)

Based upon statements appearing in the record of the social security hearings before the Committee on Ways and Means in June 1958, some members of Congress believe there is a great similarity between private insurance and the social security system. Congressman Keating (now Senator Keating) said:

> It has always been my feeling that since social security is essentially an insurance system, there should be no limit on the amounts which beneficiaries can earn, and still receive benefits . . . it is my feeling the ceiling should be removed entirely.

Senator Proxmire, who has introduced legislation greatly liberalizing social security benefits, seems to identify the social security program very closely with private insurance. He thought it "an excellent point" when Congressman Eberharter made this statement:

> . . . social security taxes are to some extent an investment by the employee, an investment to be considered as buying future security. That is the social security tax. Whereas, with respect to the income tax all the money is spent by the Government every year. Here we have a trust fund to guarantee to some extent the future security of the employee.

Also, when Congressman King said:

> . . . the average man who insures himself or buys an annuity would not consider his premiums in the same category as his taxes. . . . It is set apart, would you not say so?

Senator Proxmire said:

> That is a perfectly valid and excellent distinction. The fact is that this is an insurance system. This is a premium that he is paying. His employer is paying a part of the premium. It is entirely different from income tax. It is a benefit that comes back to him. He is buying something for himself.

In order to assure that the public will be willing to pay social security taxes on an initial bracket of gross earnings, it apparently has been necessary to present an image of a close parallel to private insurance. If social insurance were kept at the proper level to meet only social needs, it would have its own merits and distinctive characteristics and it would not be necessary to draw such a close parallel to private insurance in order to gain public acceptance. For the present and probable future level of benefits, however, this private insurance parallel is likely to build up real trouble. If employees are repeatedly told that insurance premiums are being paid by them "and on your behalf by your employer," as Dr. Larson says and Senator Proxmire believes, there is a rude awakening coming when younger persons and new entrants come to know (as they should be told now!) that the value of combined employee-employer contributions, on the average, is greater than the value of benefits. Congressman Curtis of Missouri, a prominent member of the Committee on Ways and Means, has introduced a bill, H.R. 7012, "To encourage the use of private benefit plans in lieu of social security by providing that individuals who are eligible for certain benefits under such plans shall not be entitled to social-security benefits or subject to social-security taxes." While such a proposal would be virtually impossible to operate, the significant thing is that it has been thought about and the idea proposed legislatively. Such a law would, of course, completely ruin the financing of the social security system, since it must have the subsidy payments derived from the employer contributions with respect to the younger members and new entrants of the future.

If the great socialization of contributions which truly exists is made clear to the public, there may be good reason for concern as to public acceptance of the gross income tax base. The public may well say, "General welfare benefits should be met from general revenues—pay for them by the progressive income tax."

Is there a dilemma developing which will result in eventual public resistance to payment of social security taxes on gross income, no matter which horn is selected?

If the image of social security projected by government authorities is similar to that of voluntary private insurance, of which we have seen evidence, there may arise a "din of inequity" when it is realized that the value of contributions with respect to current young workers and new entrants is greater than the value of their benefits. If the image projected is the more accurate one of substantial socialization of contributions and not one which parallels the payment of premiums for conventional insurance benefits, a clamor of unfairness may arise over taxing of the initial bracket of gross income—a regressive income tax. The author wonders whether there has been sufficient appreciation of the likelihood of the development of this dilemma. Are we deceiving ourselves as to the successful continuance of the self-supporting principle, or will direct governmental support become necessary? Has the actuarial anesthetic been too powerful?

The author believes that the lesser horn of the dilemma is to be honest as to the true nature of our social security financing method. In lieu of the statement published in the Social Security Administration's booklet previously referred to, "Your Social Security," the author recommends a statement such as the following which *does* present an accurate image:

> The financing method developed to pay for social security benefits is fundamentally different from that used for private life insurance and pension plans. The money needed to pay benefits to old-age and survivor beneficiaries comes *mainly* from the *current* contributions by employees, employers and the self-employed. For example, for the ten years from 1956 to 1965, total contributions are estimated as $102.5 billion and benefit payments as $98.5 billion. Contributions have been established in the law so that, over the years, there will be some excess of contributions over benefits. This excess is accumulated at interest in the Trust Funds. The interest earnings provide money for only 6% or 7% of the benefits.
>
> This method is sound and proper for social insurance where the objective is to provide only a basic minimum protection for widows, orphans and older people. This social purpose makes compulsory participation and contribution fair and proper.
>
> Under private life insurance and pension plans, benefits are paid for by con-

tributions of individuals, employees and employers with respect to these particular persons and the benefits secured depend directly upon the amount of such contributions. If we apply the principles of private insurance to social security, this is the way it works out:

a) The value of the benefits for most of the present participants is much greater than the value of the contributions made in respect of them by the employee and his employer (or in the case of the self-employed, by himself).
b) For present young participants and persons starting to work, the value of the employee's contributions alone will be close to the value of his benefits. Some of the employers' contributions and part of those of the self-employed will be required to provide money for benefits to those now retired and those now at the middle and older ages—that is, those mentioned in (a) above.

With a clear understanding of this method of paying for social insurance benefits, each generation can be expected to be willing to pay social security taxes in reliance upon similar payments by future generations to pay for benefits to those who are then the older generation.

If this were done, it could well be helpful in keeping social security benefits within the proper limits for covering only social needs.

SOCIAL AND ECONOMIC IMPACT OF SOCIAL SECURITY FINANCING METHOD

The Advisory Council on Social Security Financing recognized that, although a social insurance system is a necessary part of economic security,

security depends even more fundamentally on the continued ability of our society to produce a large volume of goods and services under conditions of economic stability. The Council has not considered it part of its task to evaluate in detail the effect of this system of social insurance on the stability and productivity of the economy.

The Council also declared that the social security

trusteeship is so large and the number of people involved so great that the defeat of beneficiaries' expectations through inflation would gravely imperil the stability of our social, political, and economic institutions.

The author of this paper is not qualified to appraise the broad social and economic impact of our social insurance system, but he does have some questions to which he would like the answers. He is concerned that the limited field covered by the unanimous Report of the Advisory Council will not be generally appreciated and that the Report can be a tranquilizer, dulling a legitimate and healthy anxiety which we should have as to the future successful operation of our social security financing method. Social security financing does not operate in a vacuum. Here are some questions he would like answered:

1. *How will the* MARGIN *for personal savings be affected by compulsory social security contributions which are scheduled to increase by 80% in ten years?*[12]

Is the relation of social security taxes to total personal savings a matter of significance? For the three years 1951–53, social security contributions averaged 20% of personal savings which, in turn, were 7.8% of disposable income. Then, for the five years 1954–58, social security contributions averaged 31½% of personal savings which, in turn, were down to an average of 6.9% of disposable income. For 1959, social security contributions of $9,612 million will be about 43% of estimated personal savings of $22,000 million, and the latter has been estimated as 7% of disposable income. If the 1969 contribution rate of 9% were in effect in 1959, social security taxes estimated at $17,300 million would be 78% *of personal savings of $22,000 million!* If the steadily increasing social security taxes do reduce substantially the amount available for personal savings, we should be concerned about the harmful effect on all forms of savings and, in particular, the voluntary purchase of insurance and annuity contracts. Is this an important field for research by economists of life insurance companies?

2. *How will the* WILLINGNESS TO SAVE, *particularly for purchase of life insurance, be affected when the margin for savings is reduced and there is increased reliance on old-age and survivor benefits from the government insurance system?*

To date, it has been generally believed that the social security benefits have been a stimulus for the purchase of life insurance by individuals and the provision of old-age benefits by employers and employees. Is there danger of our becoming so anesthetized by this experience that, without adequate justification, we expect it to continue?

Let us note the manner in which increases in social security survivor benefits arise. First, there is pressure to improve the benefits for those receiving *old-age* benefits and it is established that an increase is justified; next, old-age benefits are increased for active workers; and then, automatically because of the formula, all survivor benefits are increased. There is thus an enormous increase in life insurance benefits (survivor benefits), not because of a demonstrated need for them with proper regard for other life insurance in force, but *because the* OLD-AGE *benefits to*

[12] Calculations in this paragraph based on data from these sources: Disposable income and personal savings, 1951–58—Department of Commerce; Estimates for 1959—Lionel D. Edie & Company; Social security contributions—Report of Robert J. Myers to Ways and Means Committee, September 2, 1958.

present recipients were considered inadequate. This approaches being a strange ***non sequitur.*** Here is how outstanding life insurance coverage compares with the life insurance equivalent of the social security survivor benefit coverage:

Year	Estimated Amount of Life Insurance in Force as Survivor Benefits under OASI* (in billions) (1)	Total Life Insurance in Force in the U.S. (excluding Credit Life Insurance)† (in billions) (2)	Ratio of (1) to (2) (3)
1935	$ 0	$ 98	0%
1940	42	115	37
1951	170	248	69
1953	298	296	101
1955	344	358	96
1957	425	439	97
1958	475	472	101

* *Actuarial Studies* 16, 29, 31, 37, 43, 47 of Social Security Administration and letter from Robert J. Myers.

† *Life Insurance Fact Book*—1959.

If the insurance equivalent of survivor benefits under the two government programs of railroad retirement and civil service are included, the total under government programs is about $500 billion for 1958.

We see a neck and neck race since 1953, but how long can this be expected to continue? The average amount of OASI insurance equivalent for men progressed as follows:

1940	$2,300
1947	2,300
1951	3,700
1953	6,200
1955	6,900
1957	8,000

This is the kind of race where the added strength and speed of one opponent can cut down the strength and speed of the other opponent—they are not free and independent competitors. Is this an area for research for the market specialists of life insurance companies?

Are there seeds of future trouble for the life insurance business in this competition between the tax-favored compulsory governmental survivors' benefits program and the now more heavily taxed life insurance industry? The following statement of ten members of the Ways and Means Committee is noteworthy:

Individual economic security is now being provided the public by life insurance companies, other thrift institutions, and through the social security system. It is sound public policy to encourage everyone to provide for his own security on a voluntary basis and our tax laws should encourage, not deter, such efforts. This bill, however, makes voluntary provision for one's own economic security relatively less attractive since it increases the tax on life insurance while investment earnings under the social security system are free from either Federal or State tax. This increases the advantage of the social security system over voluntary individual protection offered by life insurance companies, particularly if the latter must absorb taxes of the magnitude provided in the bill. Public awareness of this differential in cost will most certainly lead to increased demand for larger social security benefits and less incentive to build security on a voluntary basis.[13]

3. *Can the social security system become an engine of inflation?*

The First National City Bank of New York expressed concern about this question in its Monthly Letter for May 1958. Here is what they said in part:

There is also the matter of the direct role the Social Security program would play in generating inflationary forces if it is repeatedly liberalized and financed by constantly rising taxes. By 1975, even assuming the present tax rate schedule is not increased, the business man will face a payroll tax of 4¼%. [They were scheduled in 1958 to increase to 4½% by 1969!]

As this tax burden rises, pushing up operating costs, the natural inclination of the business man is to protect profit margins by raising prices. Moreover, the heavier tax bite reduces take-home pay and workers want larger pay raises. . . .

As prices go up, social security checks don't go as far, and pressure is put on the Congress to boost monthly benefits to keep up with the cost of living. Taxes are then raised to pay for increased benefits and the spiral takes another upward whirl.

Marcus Nadler, Professor of Finance at the New York University Graduate School of Business, recently made this statement regarding the relation of an existing inflationary condition and the operations of pension programs.

Within the next decade, . . . the number of people aged 65 and more living on savings, pensions, and social security benefits will increase materially. These people are not likely to sit by and see their economic security further undermined [by inflation] without protesting or without bringing political pressure for remedial legislation.

Since private pensions, based on actuarial calculations, cannot easily be increased, the greatest pressure will be on the federal government to raise social

[13] Report of the Committee on Ways and Means, *Life Insurance Company Income Tax Act of 1959*, p. 88.

security payments and on state and local governments to raise pensions. This may lead to a material increase in social security and local taxes, in turn reducing take-home pay of employed persons and adding to the tax burden of the employers. Or it may lead to increased federal and local government expenditures and larger deficits, further feeding the forces of inflation.[14]

In the course of the nationwide debate taking place in Great Britain with respect to its national pension system, the British actuaries have warned of the inflationary aspects that may exist in overgenerous state programs. In a summary of a discussion by the members of the Institute of Actuaries, the following remarks by Mr. B. Robart appeared:

> The likely effect of an extended scheme on the problem of inflation could take several forms. Any failure to ensure the necessary increase in productivity to enable the benefits to be met in terms of real value would itself be inflationary. That appeared . . . to be a strong argument in favour of a state scheme's being restricted to basic need or of at least partial funding. In that an extension of national pensions requiring higher contributions would act as a disincentive to saving in general, it would be inflationary in effect. Even more would a built-in cost-of-living adjustment be inflationary in effect and would strike a tremendous blow at the existing occupational pension schemes. . . . It seemed to him that the fundamental needs to be kept in mind in any extension of state pension benefits were, first, that they should be framed on sound financial principles and, secondly, that they should be conducive rather than hostile to a stable currency. . . . As a profession they could not emphasize too strongly that a false step in the vital matter of state pensions could do irreparable damage to the economy for years to come, would inevitably continue the reduction in the real value of the currency, and perhaps place an impossible burden on the shoulders of future generations.[15] (Shades of Jeremy Bentham!)

The following wise warning by a prominent Swedish financier seems to have gone unheeded when the Swedish Parliament adopted a compulsory national old-age pension program on May 14, 1959, providing a total state pension of two-thirds of earnings at age 67 with substantial contributions from employers and participants which are estimated to produce a public pension fund of 50,000 million Crowns ($10 billion) by 1990. The pension legislation passed the Second Chamber by one vote, the social democrats together with the communists having control 116 to 115.

> A serious warning should be sounded against the idea that the required capital supply could be secured by various forms of forced savings including such obligatory pensions as is now talked of in various countries. Such systems would not be effective without giving up basic freedom. Experiences from certain

[14] *Nation's Business*, April, 1959, pp. 86–87.

[15] *JIA* Vol. 84, Part III, No. 368, pp. 260–262—Discussion of "Effect of Extension of National Pensions."

countries show how forced savings have failed to be anti-inflationary as the impact of this measure has been eluded by counteractions taken by people not wanting and not needing to accept the imposed hardships. Such countersteps could include bigger wage demands and diversions of savings from voluntary accounts to forced accounts. On the other hand a country like the Soviet Union has managed to extract forced savings with considerable success but at what price we all know.

. . . we can—apart from moderating trade union demands and election promises—do no better than limiting the public sector and drastically promoting voluntary savings to invest more to get more goods. This policy would have to include a general overhaul of taxation not to punish savings and productivity as now. Savings would be deductible from tax. It must pay to save and to work.[16]

Barbara Ward, English economist and writer, recently stressed the importance of capital accumulation for world needs in the economic competition with the Soviets and suggested that government could help by offering tax inducements to trade unionists who agree to long term wage agreements, with a heavy emphasis on deferred benefits which maintain standards in old age—that is, the encouragement of advance funding for privately arranged old-age benefits as distinguished from augmented state pensions on a pay-as-you-go funding basis.[17]

In meeting the old-age income needs of a nation, the author believes it can be done in a way involving a *vicious* circle which should be carefully avoided or a *virtuous* circle which should be earnestly cultivated. He would like to have this belief confirmed or convincingly disproved.

Here is the *vicious* circle.

(1) *Generous state pensions with little reliance on private voluntary pension programs.* This would arise from political pressures and humanitarian considerations to assure older persons of completely adequate income.

(2) *Effects of generous state pensions.*
   a) Employee—increased reliance on government; savings discouraged.
   b) Employer—greater operating costs.
   c) Economy—decrease in productivity and increased government financing of old-age benefits.

(3) *Inflation.*

(4) *Demand for or automatic increase in pensions.*

(5) ....*and the vicious circle resumes.*

[16] Statement by Mr. Marcus Wallenberg, President of the Stockholms Enskilda Bank in Stockholm, October, 1957.

[17] "Now the Challenge of an Economic Sputnik," *New York Times Magazine*, February 8, 1959.

Here is the *virtuous* circle.

(1) *State pensions covering only basic needs with major reliance on private programs and savings.* There should be no escalation provisions which aim to grant immunity to inflation to a special segment of the population.

(2) *There is a margin for savings and capital accumulation under private programs.* Burden of cost of state pensions on employees, employers and government is not heavy.

(3) *Capital accumulation nurtures increased productivity.*

a) Inflationary pressures forestalled with no demand for increased pensions.

b) Controlled increase in pensions provided as real total product permits. Pension claims are established with cost consciousness of the amount of advance funding required to support them.

(4) *Funding for larger pensions again contributes to capital accumulation.*

(5) ....*and the virtuous circle continues.*

4. *Will the willingness and capacity of our working population to pay increased social security taxes be seriously affected by the great financial demands for educational facilities during the next ten years* (to say nothing of the cost of national defense, highways, improved medical care, cultural pursuits, etc.)?

Estimates of population changes by age groups shown below indicate the great increase in the need for educational facilities compared with the small increase in number of working persons who must pay the cost. From 1955 to 1970, the total number of young people, taken as those age

POPULATION INCREASE PROJECTION
FROM 1955 TO 1970*

Age Group	Increase in Numbers	Percentage Increase
0– 4	4 million	20¾%
5–14	12 "	37½
15–19	8 "	68
20–24	6⅓ "	56
25–44	1 "	2
45–64	9¼ "	27
65 and over	6 "	42

* *Actuarial Study No. 46*, May, 1957, U.S. Department of Health, Education and Welfare, Social Security Administration, Division of the Actuary, (High Fertility and Low Mortality Assumptions) p. 27.

0 to 24, mainly a dependent group, will increase 40% or 30 million; the total number of older people, *i.e.*, those 65 and over will increase 42% or 6 million; but the middle-age group 25 to 64, largely the producers, will increase only 12½% or 10 million. There are already many evidences of taxpayer reluctance to pay the cost of educational facilities and other community needs. In the *U.S. News & World Report*, May 18, 1959, the situation is evaluated in an article entitled, "Coming: Revolt by Local Taxpayers?" Two paragraphs are quoted:

> Government, at all levels, is hungry for money. Taxpayers are grumbling more and more over the cost of government.
>
> What you find to date is this:
>
> 1. People still are voting for the things they want when payment can be made through borrowing. Between 70 and 80 per cent of all bond issues submitted to voters—both in number and amount—have been approved over the past 10 months.
> 2. Local politicians are continuing to gamble that the public will go along with steady increases in existing tax rates and imposition of new taxes to provide the money for most of the things the people would like to have.
> 3. People are voicing increased resentment at tax increases, but irritation still has not led to actual revolt in most States and communities. Some local politicians, however, look for irritation to flare into revolt by 1960 unless present trends are checked.

Leading educators are pleading for massive Federal intervention in the educational area involving the expenditure of tens of billions of dollars. How will the demands of social security contributions be accommodated in this tax-ridden environment as it becomes more acute during the next ten years? With almost demonic precision, we have managed, by a "pragmatic political process," to establish for 1969 the peak of social security and railroad retirement tax rates when the costs of education will, no doubt, be reaching a new critically high point. Is it possible that we are establishing claims on future national income for the older segment of population at the expense of adequate provision for the coming population explosion among our youth?

INCOME TAX TREATMENT OF SOCIAL SECURITY CONTRIBUTIONS AND BENEFITS

Under the Internal Revenue Code, social security contributions of employees and the self-employed are paid from taxable income (*i.e.*, they are not deductible from gross income), employer contributions are deductible as a business expense, investment income of the trust funds is tax-free and all social security benefits are tax-exempt. For a qualified private pension plan, the tax treatment is exactly the same *except* that benefits in excess of employee contributions are included in taxable income (and except for the tax on investment income paid by life insurance companies associated with insured pension plans).

It is a mystery that in the great proliferation of writing on social security, very little has been said about the significance of the income tax treatment. In the 1205 pages of the report of the June 1958 social security hearings, there is only one mention of the income tax aspects, but this one statement is noteworthy. Peter G. Dirr, appearing as a member of the social-security committee of the Commerce and Industry Association of New York, made this recommendation on behalf of the Association:

INCOME-TAX TREATMENT OF CONTRIBUTIONS AND BENEFITS

We do not favor recommendations which would permit the deduction of OASI contributions on personal income-tax returns while continuing the exclusion of social-security benefits from taxable income.

We recommend that study be given to the feasibility of (1) permitting deduction of OASI contributions on personal income-tax returns, and (2) requiring that benefits received be included in taxable income. With an increasing number of persons collecting OASI benefits, many beneficiaries are given an unneeded and undesirable tax advantage to the detriment of the revenue needs of the country. Making OASI benefits taxable would not affect those whose principal income on retirement is the OASI benefits, since individuals age 65 and over have the advantage of double personal exemptions.

What bearing does this income-tax treatment have upon the validity of the commonly accepted belief that the social security system is self-supporting?

Does the tax-exempt status of social security benefits produce effects that resemble regressive taxation?

Has actuarial anesthesia obscured important financial effects of income tax treatment?

Self-Supporting Principle

A private, qualified pension plan is usually considered self-supporting, even though some may argue that the deferred taxation implicit in the tax treatment described above does involve a tax subsidy from general revenues since the personal income tax bracket after retirement is expected to be lower than that applicable when contributions are made and investment income is earned. Whatever position is taken, it seems clear that the *more favorable* tax treatment of OASDI benefits does result in a subsidy from general revenues. Hence, we should recognize that the social security system is not self-supporting in the same sense that private programs pay their own way.

Tax-Exempt Status of Social Security Benefits

The manner in which social security benefits became tax-exempt seems shrouded in the mists of the origin of the system. Old-age benefits under the national social insurance programs of Great Britain, Canada and Sweden are includable in taxable income. Also, in Great Britain and Sweden, employee contributions for old-age benefits are excluded from taxable income. Under a compulsory national old-age program designed to meet a social need for a basic floor of protection, it seems strange, indeed, for older persons in the higher income categories to receive a tax-free benefit. That part of our national income compulsorily devoted to social purposes could well be better employed.

As has been recognized earlier in this paper, the vast majority of present participants will receive benefits of greater value than the value of contributions in respect to them. In examining the financial effects of tax-exemption of benefits, it is illuminating to have some illustrative figures as to the value of the social security subsidy. It will then be seen that the financial advantage of tax-exemption represents a further bounty for the higher income categories.

Exhibit I illustrates the value of the social security subsidy for several types of contributors. These illustrations[18] are intended to show mainly the *relative* status of different classes of persons. The subsidy is measured as the excess of the value of the old-age benefits over the value of combined employee and employer contributions. These illustrations indicate that (*a*) for the vast majority of married couples entering the system in 1937 or entering subsequently by coverage extensions, there is a subsidy having a value ranging from $10,000 to $22,000; (*b*) for most single persons among initial participants, the subsidy ranges from $4,000 to $10,000; (*c*) within the range of monthly earnings from $100 to $400, the higher the earnings, the greater the dollar value of the subsidy; and (*d*) for entrants at young ages, there will generally be a subsidy only with respect to those in the lowest income categories, thus eventually reflecting the weighting of the benefit formula in favor of such categories.

Exhibit II shows, for several types of participants, the value of income taxes paid on contributions, the value of the tax-exemption of old-age benefits, the net effect of these values, and the extent to which this net tax effect offsets, or more than offsets, employee contributions. These illustrations indicate that (*a*) the tax-exemption feature does not benefit lower-income persons because of other exemptions; (*b*) for a substantial proportion of initial entrants (exclusive of the lowest income categories)

[18] For ease of calculation, the value of survivor benefits before retirement has been ignored, thus understating the value of the subsidy.

EXHIBIT I

The subsidy is computed as the excess of the value of old-age benefits over the value of employer and employee contributions (excluding disability contributions), accumulated at 3% interest, with both values determined as of retirement age.

Average Monthly Earnings	Value of Social Security Subsidy				
	Married; Retirement at 65				
	Entry Age: 60 Retirement Year: 1959	43 1959	30 1972	30 1994	20 2014
$100....	$12,200	$11,540	$10,270	$8,050	$ 4,100
200....	17,230	15,900	13,120	8,290	400
300....	21,410	19,680	15,500	7,610	−4,230
350....	23,630	21,900	17,120	7,380	−6,400
400....	23,630	21,900	18,460	5,550	−8,630
	Married; Retirement at 68				
	Entry Age: 63 Retirement Year: 1959	46 1959	30 1975	30 1997	
$100....	$10,820	$10,150	$ 8,340	$ 5,750	
200....	15,260	13,930	10,070	4,550	
300....	18,950	17,220	11,430	2,510	
400....	20,910	19,180	13,490	− 750	
	Single; Retirement at 68				
	Entry Age: 63 Retirement Year: 1959	46 1959	30 1975	30 1997	
$100....	$ 6,400	$ 5,730	$ 3,770	$ 970	
200....	8,960	7,630	3,560	− 2,260	
300....	11,080	9,350	3,290	− 6,000	
400....	12,220	10,490	3,800	−10,480	

Assumptions: Contributions based on tax rates and wage limits applicable in the past; earnings assumed level for purposes of contributions.

Males, with wife of same age.

Value of retirement income approximated on the basis of the U.S. 1949–51 Population Table for whites, with projection for mortality improvement at Scale B, and 3% interest; as shown on the following page.

EXHIBIT I—*Continued*

Retirement Date January 1	Value per Dollar of Monthly Primary Insurance Amount		
	Retirement Age		
	65	68	
	Married	Married	Single
1959	$211.141	$187.706	$112.754
1972	218.109	....	....
1975	....	194.986	117.467
1994	229.901	....	....
1997	....	204.997	123.947
2014	229.901	....	....

Average Monthly Earnings	Value of Old-Age Benefits			
	Married; Retirement at 65			
	Entry Age: 60 or 43 Retirement Year: 1959	30 1972	30 1994	20 2014
$100	$12,460	$12,870	$13,560	$13,560
200	17,740	18,320	19,310	19,310
300	22,170	22,900	24,140	24,140
350	24,490	25,300	26,670	26,700
400	24,490	27,260	27,590	29,200
	Married; Retirement at 68			
	Entry Age: 63 or 46 Retirement Year: 1959	30 1975	30 1997	
$100	$11,070	$11,500	$12,090	
200	15,770	16,380	17,220	
300	19,710	20,470	21,520	
400	21,770	24,370	24,600	
	Single; Retirement at 68			
	Entry Age: 63 or 46 Retirement Year: 1959	30 1975	30 1997	
$100	$ 6,650	$ 6,930	$ 7,310	
200	9,470	9,870	10,410	
300	11,840	12,330	13,010	
400	13,080	14,680	14,870	

EXHIBIT II

Comparison of Net Value of Tax-Exemption of Old-Age Social Security Benefits and Value of Employee Contributions

Average Monthly Earnings	Value of Employee Contributions (1)	Value of Income Tax on Employee Contributions (2)	Value of Tax-Exemption of Old-Age Benefits (3)	Net Value of Tax-Exemption; (3) minus (2) (4)	Net Contribution after Net Tax-Exemption; (1) minus (4) (5)
	Married; Entry Age, 60; Retirement Date, 1-1-1959; Retirement Age, 65				
$ 200	$ 250	$ 50	$ 0	$ – 50	$ 300
300	380	80	0	– 80	460
400	430	90	0	– 90	520
700	430	100	1,900	1,800	– 1,370
1,000	430	110	2,390	2,280	– 1,850
2,000	430	150	3,370	3,220	– 2,790
3,000	430	200	4,350	4,150	– 3,720
5,000	430	250	6,310	6,060	– 5,630
10,000	430	320	11,450	11,130	–10,700
	Married; Entry Age, 43; Retirement Date, 1-1-1959; Retirement Age, 65				
$ 200	$ 920	$ 180	$ 0	$ – 180	$ 1,100
300	1,240	250	0	– 250	1,490
400	1,290	260	0	– 260	1,550
700	1,290	280	1,900	1,620	– 330
1,000	1,290	340	2,390	2,050	– 760
2,000	1,290	440	3,370	2,930	– 1,640
3,000	1,290	610	4,350	3,740	– 2,450
5,000	1,290	760	6,310	5,550	– 4,260
10,000	1,290	970	11,450	10,480	– 9,190
	Married; Entry Age, 30; Retirement Date, 1-1-1972; Retirement Age, 65				
$ 200	$ 2,600	$ 520	$ 0	$ – 520	$ 3,120
300	3,700	740	0	– 740	4,440
400	4,400	880	0	– 880	5,280
700	4,400	970	2,450	1,480	2,920
1,000	4,400	1,140	3,000	1,860	2,540
2,000	4,400	1,500	4,090	2,590	1,810
3,000	4,400	2,070	5,180	3,110	1,290
5,000	4,400	2,600	7,360	4,760	– 360
10,000	4,400	3,300	13,080	9,780	– 5,380
	Married; Entry Age, 30; Retirement Date, 1-1-1994; Retirement Age, 65				
$ 200	$ 5,510	$ 1,100	$ 0	$ – 1,100	$ 6,610
300	8,270	1,650	0	– 1,650	9,920
400	11,020	2,200	0	– 2,200	13,220
700	11,020	2,420	2,520	100	10,920
1,000	11,020	2,870	3,070	200	10,820
2,000	11,020	3,750	4,170	420	10,600
3,000	11,020	5,180	5,280	100	10,920
5,000	11,020	6,500	7,480	980	10,040
10,000	11,020	8,270	13,280	5,010	6,010

Average Monthly Earnings	Value of Employee Contributions (1)	Value of Income Tax on Employee Contributions (2)	Value of Tax-Exemption of Old-Age Benefits (3)	Net Value of Tax-Exemption; (3) minus (2) (4)	Net Contribution after Net Tax-Exemption; (1) minus (4) (5)
	Married; Entry Age, 20; Retirement Date, 1-1-2014; Retirement Age, 65				
$ 200	$ 9,460	$ 1,890	$ 0	$– 1,890	$ 11,350
300	14,190	2,840	0	– 2,840	17,030
400	18,920	3,780	0	– 3,780	22,700
700	18,920	4,160	2,840	– 1,320	20,240
1,000	18,920	4,920	3,420	– 1,500	20,420
2,000	18,920	6,430	4,590	– 1,840	20,760
3,000	18,920	8,890	5,760	– 3,130	22,050
5,000	18,920	11,160	8,100	– 3,060	21,980
10,000	18,920	14,190	14,230	40	18,880
	Married; Entry Age, 63; Retirement Date, 1-1-1959; Retirement Age, 68				
$ 200	$ 250	$ 50	$ 0	$– 50	$ 300
300	380	80	0	– 80	460
400	430	90	0	– 90	520
700	430	100	1,350	1,250	– 820
1,000	430	110	1,790	1,680	– 1,250
2,000	430	150	2,660	2,510	– 2,080
3,000	430	200	3,530	3,330	– 2,900
5,000	430	260	5,270	5,010	– 4,580
10,000	430	320	9,840	9,520	– 9,090
	Married; Entry Age, 46; Retirement Date, 1-1-1959; Retirement Age, 68				
$ 200	$ 920	$ 180	$ 0	$– 180	$ 1,100
300	1,240	250	0	– 250	1,490
400	1,290	260	0	– 260	1,550
700	1,290	280	1,350	1,070	220
1,000	1,290	340	1,790	1,450	– 160
2,000	1,290	440	2,660	2,220	– 930
3,000	1,290	610	3,530	2,920	– 1,630
5,000	1,290	760	5,270	4,510	– 3,220
10,000	1,290	970	9,840	8,870	– 7,580
	Married; Entry Age, 30; Retirement Date, 1-1-1975; Retirement Age, 68				
$ 200	$ 3,160	$ 630	$ 0	$– 630	$ 3,790
300	4,520	900	0	– 900	5,420
400	5,440	1,090	0	– 1,090	6,530
700	5,440	1,200	1,870	670	4,770
1,000	5,440	1,410	2,360	950	4,490
2,000	5,440	1,850	3,340	1,490	3,950
3,000	5,440	2,560	4,310	1,750	3,690
5,000	5,440	3,210	6,260	3,050	2,390
10,000	5,440	4,080	11,380	7,300	– 1,860

Average Monthly Earnings	Value of Employee Contributions (1)	Value of Income Tax on Employee Contributions (2)	Value of Tax-Exemption of Old-Age Benefits (3)	Net Value of Tax-Exemption; (3) minus (2) (4)	Net Contribution after Net Tax-Exemption; (1) minus (4) (5)
	Married; Entry Age, 30; Retirement Date, 1-1-1997; Retirement Age, 68				
$ 200	$ 6,340	$ 1,270	$ 0	$– 1,270	$ 7,610
300	9,500	1,900	0	– 1,900	11,400
400	12,670	2,530	0	– 2,530	15,200
700	12,670	2,790	1,920	– 870	13,540
1,000	12,670	3,300	2,410	– 890	13,560
2,000	12,670	4,310	3,400	– 910	13,580
3,000	12,670	5,960	4,380	– 1,580	14,250
5,000	12,670	7,480	6,350	– 1,130	13,800
10,000	12,670	9,510	11,510	2,000	10,670
	Single; Entry Age, 63; Retirement Date, 1-1-1959; Retirement Age, 68				
$ 200	$ 250	$ 50	$ 0	$– 50	$ 300
300	380	80	0	– 80	460
400	430	110	0	– 110	540
700	430	130	400	270	160
1,000	430	160	920	760	– 330
2,000	430	230	2,620	2,390	– 1,960
3,000	430	280	3,150	2,870	– 2,440
5,000	430	320	4,720	4,400	– 3,970
10,000	430	380	6,810	6,430	– 6,000
	Single; Entry Age, 46; Retirement Date, 1-1-1959; Retirement Age, 68				
$ 200	$ 920	$ 180	$ 0	$– 180	$ 1,100
300	1,240	270	0	– 270	1,510
400	1,290	340	0	– 340	1,630
700	1,290	390	400	10	1,280
1,000	1,290	490	920	430	860
2,000	1,290	690	2,620	1,930	– 640
3,000	1,290	840	3,150	2,310	– 1,020
5,000	1,290	970	4,720	3,750	– 2,460
10,000	1,290	1,150	6,810	5,660	– 4,370
	Single; Entry Age, 30; Retirement Date, 1-1-1975; Retirement Age, 68				
$ 200	$ 3,160	$ 630	$ 0	$– 630	$ 3,790
300	4,520	990	0	– 990	5,510
400	5,440	1,410	230	– 1,180	6,620
700	5,440	1,630	820	– 810	6,250
1,000	5,440	2,070	1,400	– 670	6,110
2,000	5,440	2,880	3,310	430	5,010
3,000	5,440	3,540	3,900	360	5,080
5,000	5,440	4,080	5,660	1,580	3,860
10,000	5,440	4,840	8,010	3,170	2,270

Average Monthly Earnings	Value of Employee Contributions (1)	Value of Income Tax on Employee Contributions (2)	Value of Tax-Exemption of Old-Age Benefits (3)	Net Value of Tax-Exemption; (3) minus (2) (4)	Net Contribution after Net Tax-Exemption; (1) minus (4) (5)
	Single; Entry Age, 30; Retirement Date, 1-1-1997; Retirement Age, 68				
$ 200	$ 6,340	$ 1,270	$ 0	$− 1,270	$ 7,610
300	9,500	2,090	0	− 2,090	11,590
400	12,670	3,300	270	− 3,030	15,700
700	12,670	3,800	870	− 2,930	15,600
1,000	12,670	4,820	1,460	− 3,360	16,030
2,000	12,670	6,720	3,390	− 3,330	16,000
3,000	12,670	8,240	3,990	− 4,250	16,920
5,000	12,670	9,510	5,770	− 3,740	16,410
10,000	12,670	11,280	8,150	− 3,130	15,800

Method of Calculation: All values are determined as of retirement age.

Column (2) is the product of the marginal tax bracket percentage for "before retirement" and the amount of accumulated employee contributions, excluding those for the disability benefit.

Column (3) is the product of the marginal tax bracket percentage for "after retirement" and the amount equal to the value of the total old-age benefits, shown in Exhibit I, but with $3,000 deducted from such product as the approximate value of the retirement income credit allowed by Federal income tax law.

ASSUMED MARGINAL INCOME TAX BRACKET*

Average Monthly Earnings	Before Retirement		After Retirement	
	Married	Single	Married	Single
$ 200	20%	20%	0%	0%
300	20	22	0	20
400	20	26	0	22
700	22	30	20	26
1,000	26	38	22	30
2,000	34	53	26	43
3,000	47	65	30	47
5,000	59	75	38	59
10,000	75	89	59	75

* Based upon assumptions as to relation of postretirement income to preretirement income which were considered reasonable. Value of tax-exemption of survivor benefits before retirement has been ignored.

the tax-exemption feature provides a financial advantage that increases with increase in earnings; (*c*) for a substantial proportion of present participants, the net tax advantage will more than offset the amount of employee contributions by a considerable margin, and thus they really make money from the tax-exemption feature; and (*d*) for entrants at young ages, generally, the value of taxes paid on contributions will be greater than the value of the tax-exemption—thus, in the ultimate situation, it appears that there will be a net disadvantage under the present taxation treatment.

As Mr. Dirr recommended, this matter should have the most careful study. The author believes that, if it were politically feasible, the preferred method of tax treatment, representing the one that would be most effective in restraining overexpansion of social security benefits, would be to continue the present treatment of employee contributions and include in taxable income benefits in excess of such employee contributions. However, in order to encourage private programs of all kinds, including those of the self-employed, the application of the deferred taxation principle is vital. If such principle were applied generally, including its application to employee contributions under private plans and contributions of the self-employed to voluntary retirement programs (Keogh-Simpson), it would probably be politically impossible to avoid its application to the social security system.

Accordingly, if and when the principle is generally applicable to private programs, the author would strongly favor changing to a method which would exclude from gross income social security contributions and include in taxable income social security benefits in excess of the amount of social security contributions paid in the past out of taxable income. Such a change would have these desirable effects:

a) the present unwarranted tax advantage for higher income categories would be removed;

b) entrants at young ages would have some net tax advantage as a partial easing of the great burden they will be carrying in the future to finance the system; and

c) in preparing the personal income tax return, the individual, in order to deduct his social security contribution from gross income, would necessarily have positive knowledge of its amount and, accordingly, there could very well be a greater awareness of social security costs than under the present system, where most persons are not aware of the amount they are paying under the payroll deduction system.

CONCLUSION

The exploration of our social insurance problems reflected in the foregoing observations and questions has led the author to a major conclusion: before any further increase in social security benefits is considered, the broad social and economic impact of the level of benefits and the method of financing should be studied by the best qualified individuals in the United States. The current Report of the Advisory Council is limited to an analysis of the method of financing taken alone—as it might operate virtually in a vacuum. But the broader impact of the system needs study in relation to capital needs, capacity to save, other demands upon our production, and the role of private retirement plans.

The author finds this opinion shared by others. At the 1958 social security hearings, former Secretary of Health, Education, and Welfare Folsom gave the following reply to a question as to whether he would favor a bill providing a 10% increase in benefits with tax sufficient to finance it:

> No, I would not. I would say that, if we plan to consider a broad increase in benefits and taxes, I think it ought to be carefully studied by an advisory council, as in the past. In the past, before any drastic changes were made, they were studied by an advisory council who looked at these problems objectively from various viewpoints. Also, since we have the Advisory Council on Financing working on the problem, we ought to get the report of that Council before making changes.

At the same hearings, A. D. Marshall, speaking for the Chamber of Commerce of the United States, emphasized the importance of recognizing (1) that the soundness of the system "depends upon the willingness of those working in years to come to pay larger social taxes," (2) other demands on the patently limited tax sources, and (3) restriction on ability to save by high taxes and discouragement of personal thrift by high benefits. He recommended:

> In summary, we believe a new Advisory Council should be appointed by Congress. The present Advisory Council has a life of 1 year, and the members were selected to study 1 area only—financing.
>
> Consequently, a new Advisory Council should be appointed to study these other areas and to make feasible suggestions for constructive action, consistent with the preservation of individual freedom, initiative, and responsibility.

British actuaries also have recently voiced a vigorous opinion in favor of a major study in depth of national pensions in Great Britain. This view is given in a booklet, dated May 1959, entitled "An Appeal to Statesmanship," issued by the Councils of The Institute of Actuaries and of The Faculty of Actuaries in Scotland. Several paragraphs are quoted:

There has been much useful discussion about national pensions during the past two years but some important aspects are escaping the attention they require. To the actuarial profession, with a century of intimate experience of pension schemes, this causes grave disquiet.

To fill this gap we are issuing this booklet. It is mainly about costs, particularly future costs—not because we think that costs are the only aspects of importance, but because they indicate the obligations placed on future generations.

It is the voice of the future which is noticeably absent from present discussion: our responsibility as actuaries is to make that voice heard.

We have explored carefully to see whether there is any form of discipline which can be incorporated into the proposed schemes to ensure that they will not be subject to extension without full public appreciation of all the future financial implications. We are convinced, however, that the nature of the schemes precludes an effective internal discipline. The dangers lie in the very nature of any type of graduated pensions where the promises take many years to come to full maturity.

It is our strong recommendation, therefore, that with the mutual consent of the political parties there should be set up an authoritative and independent body to guide the country through the financial, economic and technical aspects of this peculiarly difficult problem. Ultimate decisions must rest with Parliament but only after thorough and quiet examination by an independent body.

A major study of our social security problems should include:

a) An effort to gain a better understanding of the nature and implications of our method of financing.

b) Development of a clear national policy as to the role social security should play, including solution of the elusive problem of what constitutes "basic need" and "basic floor of protection."

c) Determination of the best way by which *a correct image* of the social security system may be presented to the "man in the street."

d) Examination of the desirability of publishing periodically the entry age normal cost, and, in order to show the burden to be borne by future contributions, the changes in the unfunded liability.

e) Study of what part of our future national income may be soundly committed for the benefit of the older segment of our population.

f) An appraisal of the income tax treatment of social security contributions and benefits.

g) An examination of the question of whether a direct subsidy from general revenues will be necessary to make the financing of the present level of benefits popularly acceptable.

h) A study of what should be the respective roles of a national compulsory pension system and private pension plans, recognizing that, one way or another, our older age population segment will be provided with adequate living income, and also bearing in mind the fact that a national system is financed essentially on a nonreserve basis and private retirement programs are usually financed on a full reserve basis which provides substantial capital accumulations.

Such an investigation should clear the heads of those who have become anesthetized by actuarial balance sheets!

We may speculate that Jeremy Bentham, with an assist from William Cullen Bryant, would advise our generation that it should

So shape the commitments to be met
By future generations, and
"So live, that when thy summons comes to join
The innumerable caravan, which moves
To that mysterious realm, where each shall take
His chamber in the silent halls of death,
Thou go not,"
with a great feeling of guilt of what thou hast
done to future generations,
"but, sustained and soothed
By an unfaltering trust"
that thou hast *done right* by thy grandsons
and granddaughters,
"approach thy grave,
Like one who wraps the drapery of his couch
About him, and lies down to pleasant dreams."

DISCUSSION OF PRECEDING PAPER

HERBERT L. FEAY:

Mr. Peterson's paper presents a challenge to those who desire a satisfactory social security system for a democratic society.

The criticisms that have been made of social security since the system was first established in the thirties remind me of the fable I read in grade school in regard to the father, the son and the donkey on the way to market. Regardless of whether the father rode and the son walked, the son rode and the father walked, or they both walked and carried the donkey, there were those who criticized.

In the middle thirties, the social security system was criticized because of attempts to put the system on a prefunding basis with an accumulation of reserves to meet future costs. The call was for a pay-as-you-go system with current social security taxes equal to current social security payments. Now the system is criticized for insufficient reserves for the existing persons covered by the benefit provisions and for excessive taxes to be collected from new entrants. The system is damned if it does and is damned if it doesn't.

I share Mr. Peterson's concern over the fact that the social security taxes for new entrants will have a value considerably more than the value of the social security payments that the new entrants as a class will receive. This must be the result if the accrued liability for current persons included in the system is to be ignored and pay-as-you-go principles are to be followed. I also share the concern of those who question the accumulation of a large reserve fund if that fund is to be invested in the assets of the private economy of the nation. One reason is that if the government is to provide financing for private business, that should be done as the result of a direct decision to do so and not as an unplanned result of a social security reserve system.

This seems to pose an insolvable dilemma for the social security system, but Mr. Peterson has a recommendation for the civil service retirement system that could be extended to social security old age benefits. He advises that the unfunded liability for the civil service retirement benefits should be covered by the issuance of interest paying bonds.

For the social security system, the social security taxes should be only slightly in excess of the normal cost for the benefits for new entrants. The accrued liability for the existing participants in the system should be covered by interest bearing bonds issued by the Federal Government to the social security system. These bonds need no maturity date and it should be impossible for the administrators of social security to sell the bonds on the open market. The accrued liability will thus be recognized as a charge against the entire economy and not against future new participants in social security.

Any time that Congress votes an increase in benefits for existing participants in the system, the increase in the accrued liability must be recognized by the immediate increase in the interest bearing bonds issued to the social security system.

As pointed out by Mr. Peterson, the Federal budgets will need to include the interest payments on the bonds, although to the extent that the reserve liability increases these payments can be covered by additional bonds. Once the bonds are issued and the social security system has matured, the interest payments will be required for current benefit payments. Payment of this interest in cash will be accepted as an established obligation of the government.

Of course, for the same benefits the same results are secured if future social security tax rates are kept at the suggested level and Federal grants voted to cover deficits. However, this procedure leaves social security open to uninformed charges of subsidies. Many persons in the nation who would consider that subsidies are bad would not object to interest payments on bonds. A rose by another name does not seem to be as sweet!

A further advantage is that if Congress is required to vote for bonds to cover the increase in the accrued liability when benefits are increased, more adequate consideration will be given to the advisability of the increase in benefits.

I am disturbed by Mr. Peterson's sense of resignation that in a democracy decisions to be made by our representatives in government must inevitably be reached by a process of political pulling and hauling and compromise and with an eye to the necessity of being re-elected. We are told that this nation is a leader of the free world and of the nations with free government freely elected by the people. Does Mr. Peterson indicate that things are not what they seem and that it would be better if those in authority in government did not have to face the necessity of being re-elected?

Mr. Peterson points to the failure to provide proper unfunded liability payments to the civil service retirement system as proof of his apparent mistrust of elected officials. In this particular instance, the majority of the members of Congress who "must face the necessity of being re-elected" voted for the payments. It was the President who presumably will never have to face the people of this nation in another election who vetoed the bill.

After this criticism of elected officials and of the funding of the civil service retirement system, Mr. Peterson makes the statement: "Experience has demonstrated that pension programs have a far better chance of being soundly conceived and funded under private auspices than in a political environment." This is a far-reaching conclusion from the evidence given in the paper prior to that statement. An example to the contrary is the state employees retirement system of the State of New York.

Mr. Peterson questions the social security system and the railroad retirement system. In his introduction he praises the skillful professional work of the actuaries of these systems. I fully agree with him in this compliment, but I cannot help but contrast the careful studies of these actuaries with the lack of investigation for many of the private pension plans in the nation. Termination rates used in some cases are just guesses. Disability benefits are valued on the Class (3) basis and both disability and death benefits are valued with one year term factors. Inaccurate cost estimates are excused by the so-called axiom of pension funding, that ultimately costs are determined by benefits paid, plus expenses, and less investment earnings, rather than by assumptions or funding methods. We are also told that elaborate refinements in calculations are not only unnecessary work, but also bemuse the client.

There is another paper being presented to this meeting on the investment risks for pension funds. The variations in income and disbursements discussed in this paper can happen. As actuaries, we know that if an event has a probability of happening it will, in the long run, happen in accordance with that probability.

It may be said that these criticisms apply to self-insured plans and not to insured plans. Let us look at the record on this. Costs of group annuities when first issued were determined on the level premium and single premium valuation standards and benefits earned each year were guaranteed. Now we have various types of deposit administration contracts with no more guarantees for cost estimates than for a self-insured plan. Company actuaries can apply the same axiom as the consulting actuaries.

I will illustrate with an example. A consulting actuary determined the first year cost for a pension plan. This plan included a disability benefit with a substantial deferred cost. The consulting actuary used railroad retirement information for disabled lives and Benefit 1, Period 2, rates of disability from the 1952 Reports.

He calculated an entry-age level normal cost and accrued liability for the benefit. The insurance company actuary used one year term methods with Class (3) disability rates and Class (3) select disabled life annuities. These Class (3) cost factors were applied to the benefits of the relatively few employees currently eligible. This procedure produced a low cost figure for disability benefits. Anyone interested can find a discussion of the subject on pages 330 to 336 of Volume VII of *The Proceedings of the Conference of Actuaries in Public Practice.*

Insurance companies have not only made efforts to eliminate the difference between self-insurance and company insurance on the liability side of the statement but are now endeavoring to do so on the asset side. We have demands for laws for segregated assets funds, for common stock investments, and for variable annuities. Is the common denominator for private pension plans to be at the lowest level of security for the individual participants in the plan?

Another paper presented to this meeting tells us of the social security system in the Soviet Union. We are frequently reminded in the public press and elsewhere that the executives and legislators of that nation are not faced with the necessity of being re-elected.

It seems to me that our nation is faced with a challenge. We must work to develop and regulate our social security systems, both public and private, so that the world can see that our economic society can properly meet the needs of the people. The systems we now have are a mixture of individual and collective plans and some combination of these will be continued. The Russian system as described by Mr. Myers is primarily a collective system but does have some features permitting individual choices. To a certain extent, it can be said that our system must prepare for some creeping socialism and the Russian system for some creeping individualism.

Near the end of his paper, Mr. Peterson involves us in some circles. I have already taken more of your time than I should have so that I shall not travel around these circles at this time. As I see it, with the same benefits and contributions or tax payments, the effect on the general economy can be the same regardless of whether the assets of the system are controlled by a governmental agency or by private corporate trustees. One question that we should ask ourselves is: What will be the result if a substantial proportion of the stocks and bonds of our major corporations are held by private corporate trustees who neither own the assets nor are responsible to the people as are elected representatives in government? Such ownership is neither people's capitalism nor socialism. I have no definite answer to such a question at this time.

A final point is in regard to the cost of social security. Social security costs are small as compared to the cost of wars. There are those who suggest that a great reduction in our armament spending could cause our economic system to collapse. One way to avoid this can be to channel funds to social security and also to the schools which Mr. Peterson mentions in his paper. This channeling does not have to be entirely at the Federal level. Reduced Federal taxes can become an incentive for action at state and local levels of government and by individuals and private corporations. If the armament load is not greatly reduced, I agree with those who indicate that the next war will leave us with no social security problems. The survivors will have the problem of a day-to-day existence among the ruins of civilization.

W. RULON WILLIAMSON:

I want to congratulate Mr. Peterson on a courageous and timely paper. It is courageous because a busy man can rarely take the time to reconstruct the extensive background behind the current misconceptions. It is timely because the façade of plausibility of the jerry-built structure OASI is showing widening cracks.

As minor points to note at once, Mr. Peterson's discussion at times implies:

1. That *Social Security* and *OASI* are synonomous.
2. That OASI is meant to be only a pension plan.
3. That OASI should be a pension plan.
4. That while a limitation to the financial side is inadequate in a probe into OASI, there isn't time to go thoroughly into the political and philosophical foundations of the heresy.

Old age welfare is but one of the rooms in the social security or welfare state house. Others are birth, marriage, death, disability, unemployment, medical care, industrial injury, family subsidy, and then it reaches out to contiguous personal responsibilities in ever-widening circles, adding more and more rooms to the house. Concern for old age appears under both OASI and Public Assistance in the initial studies of the Committee for Economic Security, and in the provisions of the Social Security Act of 1935. In both systems it is tied in with orphan children, and in the development of both systems additions are constantly being made to the categories included. The Forand Bill aims at expanding OASI by balancing the medical care available under Public Assistance by medical care under OASI—much as though it were a book-dividend from the Book-of-the-Month Club. Blending is not limited to finance. There is already an integration of many diverse elements.

Perhaps fortunately, the quality of understatement, attributed to our

British writers, persists throughout the paper. The author does not protest too much, but too little. He does not say that the average personal tax (when paid at all) has risen from $9 a year to well over $60 in 23 years. He does not show how the average wage on which tax was paid is a much smaller sum than the average wage that determines benefits. He does not bring out that the average primary beneficiary has not yet "chipped in" a nickel toward the presumptive dollar of benefit expected by him and his dependents, though he does indicate the prospect of overpayment for benefits in the future. He does not show that more dollars have been paid in benefits and administrative costs from Federal funds for OASI and Public Assistance than all the taxes paid by individuals and corporations and employers under OASI since the start. In a sense not a cent remains of "contributions" (that pleasant designation for taxes), so that all benefits in the future will have to have money raised to meet them. He doesn't dwell on the unkindness of sheltering the citizen from the personal problems of life so as to stunt his growth.

But since the actuary has been a "fall guy" from the time of the first German use of "*social insurance*"—selectively quoted as vouching for soundness and correctness of welfare state actuarial innovations—Mr. Peterson has wisely challenged the young actuaries to extend their education. The mental disadvantages of pauperism—a drag on the neighbors—balance any slight monetary convenience from the doles.

What Mr. Peterson has shown should be frightening, and he hasn't told the half. He does stimulate one to search his memory for pertinent comments on this tremendous liability to the American people. When one blends sentimentality, sentiment, economics, cost-accounting, common sense and political glamour, arithmetic is apt to suffer. Mr. Peterson has dragged it in again.

Under the general heading of "misconceptions" and "missing perceptions," I should like to make ten points, some of them barging into the "actuarial anesthesia" too.

1. The adjective "social" suggests to me "something for the good of society." It is surely not good for society to lose long-standing standards of value, the right to work, respect for authority, the feeling of self-sufficiency, the sense of equity, the art of using arithmetic. All of these have suffered under "social security."

2. *Security* in the United States welfare consideration was a synonym for the word *insurance*, of the German and British earlier experiments. Here, *insurance* had not been a Federal function, and the Supreme Court was reassured that old age benefits should not be so considered. *Security* would have the proper connotation of dependability to replace *insurance*,

and had already been used by Socialist Abe Epstein in his long-standing mission. After the Social Security Act of 1935, Epstein was led to call it "The Social Insecurity Act" in a paper in *Harpers*. Using *security* with its aura of confidence-building, successive Commissioners of Social Security and Secretaries of the Department of Health, Education, and Welfare, in their brief successive tenures of office, have expanded or recommended expansion of the system till I can justify the great expectations of the covered at $\frac{2}{3}$ of a trillion dollars of what I call "accrued liability for past service." The trust fund of \$21 billion would be some 3% of that liability.

3. *The clean bill for financing*. Various financial or theoretic advisory councils have been carefully picked from 1934 to 1959, seemingly to reassure the American public. They have consistently rendered the judgments desired by those appointing them. They have avoided, as Mr. Peterson indicates, the deeper spirit of objective review of the created entity, sprouting new heads. Here are the "dead hands" of Marx and Keynes, Carnegie and Rockefeller, Harry Hopkins and Franklin D. Roosevelt. The blend of doles and thrift, the outstretched hand, outstretched for giving, but outstretched so far, more for getting, largess, funds both reserved and spent—reminding some of the Good Samaritan and others of Ponzi—may produce offspring as sterile as the jackass, or as prolific as the jack rabbit. But the large denial of early and current benefits by the taxpayers of today does not bode well for the validity of the half-promises, so much more grandiose, presented to the taxpayers of tomorrow to be honored.

4. *The actuarial tools*. The use of statistical tabulations to derive probabilities, the level-premium methods of providing for a lifetime of rising individual costs, the investment of funds beyond current requirements to yield an income from interest, dividends and rents, the adequacy of individual charges to meet individual requirements, the determination of clear sales arguments, and the research to back them up—none of these methods of *the actuary* has been consistently used here. ("*The actuary*" here means the whole life insurance administration!) The patterns of individual tax payments year after year have not been sufficiently prepared, but so far as "John Doe" is concerned, in his infinite variety, any correspondence between the structure of OASI and the Ordinary insurance business seems purely fortuitous. The taxes to date are unreasonably low as illustrating a century of operation. The sales arguments conditioning the later taxpayers to the higher taxes, noted by Mr. Peterson, seem surprisingly tawdry, and the national accounts are themselves far from reassuring, when national, state and local debt, supplemented by private debt, represents so heavy a mortgage against our national wealth.

5. *Interest*. Whereas interest, dividends and rents in Ordinary life busi-

ness are a natural result of the invention of life insurance to deal with deferred probabilities of death hundreds of times the early probabilities, interest seems to function in OASI mainly to reduce infinite liabilities and assets to finite items. If by this method accrued liabilities of $350 billion were derived, it is clear that the interest paid on the $21 billion of the trust fund would only justify the use of six one-hundredths of any proposed rate of interest for discount purposes. I prefer to assume no interest earning. When I listen to Congressional debates on these subjects and follow their votes for the unknown and undecided philosophy, I have no encouragement for counting on interest returns on a negligible trust fund. Interest rates, used with tongue in cheek, may mislead the Congress. They need not fool the actuaries.

6. *Miracles.* There are certain impressive miracles set down in Holy Writ, performed by men of sanctity. It would seem to take a miracle to convince the taxpayers of the near future that they want negative doles instead of positive doles. It would require a miracle—after long-continued ignoring of arithmetic—to meet the increasing liabilities built up with monopolistic nonchalance and arrogance. We are not justified in trying to "pass a miracle" to carry through the hypocrisy of this system.

7. *Dollars and percentages.* As inflation takes away from the recipient much of the values of the near-doles given under OASI—and that in a capricious and discriminatory fashion—the rising dollar costs are often explained away by talking of the superiority of percentages over dollars. Here are a few percentages to consider:

a) From 1937 to 1959 great groups of per capita taxed income (personal income, I mean) seem to have perhaps tripled, or reached 300%.
b) From 1937 to 1959 "coverage" of persons has risen to 3½ times or to 350%.
c) From 1937 to 1959 OASI taxes have advanced 17 times or to 1,700%.
d) From 1937 to 1959, benefit and administrative costs have probably gone up to 10,000 times, or 1,000,000% of the first year load.

I should say that from 1937 to 1959 the confidence in the dollar had dropped astoundingly, and the sense of dependency increased in the same percentage.

The percentage which the OASI personal tax payments bear at the time of award to expected benefits to the taxpayer, now a primary beneficiary, and to his dependents and survivors—awards of 1937–1959—must be below 3%.

The buying power of the dollar has dropped some 50%.

Adopting Mr. Peterson's quality of understatement, a system with such percentages does not inspire enthusiasm in my breast!

8. The OASI tax on individuals is a second income tax, and just as the existence of the progressive Federal income tax has developed, as a reaction, a thousand tax-saving devices, so the second income tax is developing them too. Since the blend of charity to tax entering the benefits can be 97 parts charity to 3 parts of self-provision to date, and Mr. Peterson is concerned that later the charity would be -60% and the self-provision 160%, I have more figures to give him. Nearly 80% of all the taxes collected (considerably more than all the individual taxes paid) have gone out as benefits and administrative costs for OASI and nearly 30% more is the Federal outlay to subsidize the charity under Public Assistance. I like to think that those bonds in the Trust Fund represent such expenditures from Federal funds, rather than the Foreign Aid or the beautiful buildings in Washington. With all the money gone to be generous to paupers, we could consider all the taxes for mechanized charity, and therefore free of the further imposition of the progressive income tax. But I have a proviso of some importance—that benefits should be well below subsistence benefits, and that the *promise* of future benefits should be dropped. Then the *givers* would not feel like loan sharks. Then the benefits also would logically be free of the same progressive income tax. Now the major appeal in OASI is to personal cupidity. True voluntary charity is still something of higher order. But the Supreme Court was told in 1937 that this was charity, and that the taxes were to meet the benefits and did not represent insurance premiums. I like to think that the Court might have been right in accepting that explanation.

9. *OASI's obsolescent terms.* It might be well, in describing OASI, to outlaw the following expressions: "pay-as-you-go," "self-sufficient," "dignity" in receiving the pauper dole, "he paid for it," "a modern form of thrift," "actuarial balance," "intermediate cost estimate as evidencing balance"—since all of these have been stumbling-blocks on the way to "perception."

10. *Repetition.* Many of these comments have appeared, some many years ago, in other places: "Social Budgeting," "Some Backgrounds," testimony before Congressional Committees, Annual Reports to the American Association of University Teachers of Insurance, "Death 'n' Taxes" and discussions of other Social Security papers. But in the face of Congressional action and voting records, many of these papers also suffered from the understatement of overtolerance.

Conclusion. I strongly back the protests in Mr. Peterson's paper. I am happy to see him join the roster of discoverers of the actuarial anesthesia, stemming from actuarial discovery of politics wedded to welfarism. Those that come to mind are A. D. Watson, Gelles, Immerwahr and Jarvis Farley. Two books repay rereading: *Social Security in America*, and *The Failure of the New Economics*. The first is the report of the Staff servicing the Committee on Economic Security, published in 1937, two years after the enactment of the Social Security Law of 1935. Pointing up the blind spots of that day suggests humility in approaching the next quarter-century. The other one is by Henry Hazlitt, a critique of Lord Keynes' *Theory of Employment, Interest and Money*. It indicates the vagaries of the man with a world view. Since one of Lord Beveridge's supports of his Plan is his reported deal with Keynes, that book is pertinent too. Doubtless agonizing reappraisal lies ahead.

Finally, the creature being investigated seems a headache all over the world. Our own approach, that *destitution* was being relieved or prevented, does hark back to the Elizabethan Poor Laws and local community responsibility for defectives, dependents and delinquents. Sociologists go back before Jamestown and Plymouth. Probably there is something Victorian in hiding the seamy side of life, or prettying it up with innocuous phrases. If we have the courage to go further in our diagnosis we shall find the need of some extensive, expert surgery.

ROBERT J. MYERS:

Mr. Peterson has presented a paper that is indeed very thought-provoking and stimulating. He has turned his attention to a great many facets of the social security picture, and so it is likely that, regardless of who the reader may be, he will find both many points of agreement and many points of disagreement. In any event, I believe that all can agree that Mr. Peterson has done a valuable service in presenting this paper and thus causing many people to examine further the subject of social security financing and related actuarial matters. I am certain that all actuaries in Government service are always grateful and pleased with the interest in social insurance programs expressed by other actuaries, both as technicians and as citizens. We certainly hope that this interest continues and grows and especially that younger members of the Society will develop an interest in this challenging field, which is so important in our national economy.

It is very difficult to decide just how to begin discussing this paper because it deals with so many different aspects of the subject. In the following remarks, I shall deal primarily with points of difference that I have with Mr. Peterson and shall not mention the many points where I am in full or substantial agreement with him. In brief, it can be said that in his general consideration of social security programs, Mr. Peterson points out many dilemmas without offering solutions. This, of course, is a perfectly proper position for a writer to take, but still we must be faced with the fact that when a social security program is to be developed, certain choices must be made, none of which are "perfect" from all angles. Thus, for instance, we have the long-standing conflict between the principles of social adequacy and individual equity, of which the former seems far more important, but when it is followed, a choice is then made against individual equity. The same type of dilemma holds true in regard to possible financing procedures, none of which is completely satisfactory in all respects to everybody. Then, too, the benefit structure, which really should be considered first, can have important effects on the financing basis.

As a general matter, it seems to me that Mr. Peterson's analysis draws too greatly on the viewpoint and approach of traditional pension plan funding. Although social insurance has certain similarities with private pension plans in regard to financing matters, it is considerably different because of the greater degree of social adequacy as against individual equity and because of the plausible hypothesis, since the social insurance plan is compulsory on a Governmental basis, that it will continue indefinitely into the future.

One of the things Mr. Peterson is deeply concerned about is the image in the public mind that may be created by glossing over the differences and emphasizing the similarities between private insurance and social insurance. He, of course, does not go as far as some who object to the use of the word "insurance" under any circumstances in connection with the social security program—on the basis that "insurance" must involve a contract and is not merely descriptive of the mechanism of broad pooling of risks. Admittedly, and as Mr. Peterson points out from several well-chosen examples, there has been an overuse of the word "insurance" in connection with the OASDI program.

In recent years, however, the Social Security Administration has made a considerable effort to use the proper terminology and to avoid incorrect analysis between social insurance and private insurance. In this connection, Mr. Peterson criticizes a statement from our Informational Release, "Your Social Security" (OASI-35, January 1959), describing the financing basis of OASDI. I am afraid that I cannot see the point of his adverse criticism, since the statement merely says that the taxes go into the Trust Funds and that benefit payments are made from the Trust Funds. Mr. Peterson says that replacing "taxes" by "contributions" would then make the statement more appropriate for a "full reserve" private insurance program than for social insurance; this certainly does not seem the case, because under the former type of program it is fundamentally and necessarily required that, as a basic condition, the fund be of at least a certain magnitude at any given time so that it need not depend on future new entrants to assume fulfilling its obligations to current members.

In connection with Mr. Peterson's discussion of social security financing matters, it seems to me that a number of pertinent questions can be raised in connection with points that he seemed to assume have simple and precise answers.

First, are employer contributions directly and completely allocable to individual employees? In my opinion, this is not the case. In fact, it is really difficult to say who does pay the employer cost in the end—it might be borne in whole or in part by the employer, by the employee, or by the general consumer, and these three groups are, of course, overlapping to a considerable extent.

Second, are employer contributions under private pension plans individually allocable? Once again, I do not think that this is the case, but if it were so, as Mr. Peterson seems to assume is the case for OASDI contributions, then certain of his criticisms about OASDI would be equally applicable to private pension plans.

Third, do employees covered under OASDI recognize in fact what contributions they are actually paying? To a very considerable extent, many employees do not realize the amount of their contributions because they are deducted from pay. Accordingly, as the contribution rate rises under the schedule in the law, there may not be the great public outcry that Mr. Peterson envisages. This situation as to nonrealization of the amount of the social security taxes payable does not prevail for the self-employed, who must compute and pay the self-employment tax at one single time each year. Mr. Peterson seems to feel that when the OASDI tax rate is quite high, this will be precisely recognized by most covered individuals, and they will then go to the trouble of making actuarial calculations to determine whether they are getting their money's worth, taking into account—at least alternatively—the employer contributions. I cannot believe that this will happen very often.

Quite naturally, there is not by any means a direct correspondence or similarity between OASDI benefits and those available from insurance companies, so that any comparison is difficult, or even impossible, to make. I think that as an empirical matter—even though the contribution rate rises to about double its present level—covered employees, including even those at the highest earnings levels, will on the whole get their actuarial money's worth in benefit protection provided by the system. This, of course, would have to be measured on a broad group basis, taking into account family status, retirement probabilities, etc. Of course, for the self-employed who pay $1\frac{1}{2}$ times the employee contribution rate, the situation is considerably different, but I believe that this group can, and should, be viewed as having part of their contributions taken as representing employer contributions and pooled among the entire covered group.

Mr. Peterson raises the point that, in the long run, covered employees do not receive benefits equivalent in value to what would be purchasable from the combined employer-employee contributions. This quite naturally must be the case. As long as the system is self-supporting from the contributions of the employers and the covered individuals, and as long as benefits of significant amount are payable in the early decades of operation under the social adequacy principle (so that the program can be effective), then it must mean that this payment of sizable benefits in the early years results in a cost far greater than the employer-employee contributions in respect to the individuals concerned. This cost, therefore, must be "paid for" out of the contribution income over the long range, which can be viewed as coming from the pooled future employer contributions.

As a result, for new entrants in the future after the ultimate tax rate has gone into effect, only a relatively small amount of their benefit protection comes from the current employer taxes, most of which are utilized for the initial older group covered under the program.

Mr. Peterson refers to a "160% of normal cost" upper limit to be applied to the combined employer-employee rate, or 80% in regard to employee tax alone, as stated by Latimer and Reagh in regard to the railroad retirement system. Certainly, I do not believe that such a rigid measurement is applicable to the broad social benefit system that is OASDI.

Since there is this close balance between the value of the protection for new entrants and what they pay in contributions, Mr. Peterson seems to be criticizing the principle that employers and employees should share the cost equally even though a considerable proportion of the cost is due, in effect, to the crediting of prior service for the initial covered group. But what would Mr. Peterson want to do about this dilemma? Would he want to alter the principle of equal contributions from employers and employees that seems to have stood the test of time so well among the various groups concerned with the operation of the program? Or would he want to introduce a Government subsidy into the program and thus destroy the self-supporting basis, which seems on the whole to have produced sound financing for the program?

In my opinion, the introduction of a general Government contribution could be a very serious "foot in the door," so that eventually the program could be unduly liberalized because there would no longer be the financial controls that there are now. In other words, liberalizations could be proposed that would not need to be financed at all by employer-employee contributions, but rather, as some might say, the Government contributions "could always be increased to meet such costs." On the other hand, under the present self-supporting basis, the Congress has always tried to finance any benefit liberalizations by appropriately adjusting the financing provisions applicable to covered employers and workers.

Mr. Peterson makes a considerable analysis of the railroad retirement system, but I believe that discussion on this point will be made in considerable detail by Mr. Niessen. I might, however, state that, in my opinion, the past trends in the railroad retirement system are not necessarily indicative of things to come under OASDI. For one thing, the railroad retirement system is, in a sense, a combination of OASDI and a private pension plan. Thus, the ultimate employer-employee contribution rate of 18% now scheduled for 1969 and thereafter is 9% above the corresponding OASDI ultimate contribution rate of 9%. This additional 9% cost is not unusually large in comparison with the cost of many liberal private pension plans (including the amount of the employee contributions, if present).

Furthermore, in regard to the effect of the increasing schedule of contributions, there may be some who feel that every time the contribution rate goes up, the benefits will have to be increased, so that there will be a perpetual chain of increasing costs. I do not believe that this is at all the case. As you know, next year the contribution rate is to be increased by 20% relatively, and yet we currently see nothing in the press or in public reaction about this particular matter. We do not receive letters from people saying that now that the contribution rate is going up, they expect the benefits also to be increased. I think in this respect the public is much more knowledgeable about the system than we give them credit for.

Mr. Peterson has expressed concern over the fact that the benefit level has risen so greatly over the more than two decades of operation of the OASDI system. And it is quite proper to be concerned about the matter of the *relative* benefit level of the program. There are some who believe that the benefits should be at far more than a floor-of-protection level. This, in essence, would mean the diminution or disappearance of private pension plans covering the general category of workers and also of much individual savings. But has OASDI really moved far in this direction? Since 1940, benefits have been increased on four separate occasions, and the general level in terms of dollars has approximately tripled. This compares with an increase in the general price level of about 2½ times and a rise in the general wage level of about 3½ times. Thus, the general benefit level has not really been liberalized relatively.

Mr. Peterson made some very interesting remarks about the financing of the civil service retirement system and some of its past developments. Personally, I quite agree with him except for his radical suggestion that the entire unfunded accrued liability—now more than $25 billion—should be immediately funded by the issuance of a corresponding amount of Government bonds. Politically, this would be "impossible" because of its almost catastrophic effect on the current budget and on the national debt. I believe that the "normal cost plus interest on the 'initial' unfunded accrued liability" method is quite suitable for this system.

Another facet of the paper is the discussion of the income tax treatment of OASDI contributions and benefits. Mr. Peterson makes much of the fact that because OASDI benefits are not subject to income tax, the system is not really self-supporting. The same argument can also be made because of the fact that employer OASDI contributions are considered a business expense for income tax purposes, so that in many instances it can be argued that about half of these OASDI taxes would otherwise have been paid as corporate income taxes. I cannot accept the validity of either of these points because, as argued before, it is impossible in this economic world to pin down the incidence of taxes and the matters of "what would have happened if the situation had been otherwise."

Likewise, I think that Mr. Peterson's concern about the income tax treatment of benefits, such that the higher income individuals (and particularly the highest ones) stand to gain greatly, is really not too serious. After all, in the aggregate, these persons are bearing, and have borne, a relatively large share of the total taxes. It thus does not seem to be a proper and full analysis to consider one element of the taxation system in isolation of all others. And from his Exhibit II, it seems that the "worst" cases are for the relatively few extremely high-paid ($60,000 a year and over) individuals now aged 50 or over.

Personally, I would agree with Mr. Peterson that OASDI benefits should be taxable on exactly the same basis as any other retirement benefit. In the vast majority of cases there would be no income tax payable because of the double personal exemption for the aged and the retirement income credit (which would, of course, need to be modified to allow OASDI benefits to count against it). The present complete exemption of OASDI benefits is based on an early ruling of the Bureau of Internal Revenue that these benefits are "gratuities"—a difficult matter to "explain away" by those who wish to stress the "insurance" nature of the program!

Mr. Peterson's reference from the *Wall Street Journal* is, of course, correctly given, but it might be noted that their thinking was hazy not only in regard to the OASDI financing method but also in regard to general arithmetic. Thus, the original law called for a maximum tax of $30 in 1937–39, but a maximum ultimate tax of $90 in 1949 and after. The 7-fold "anticipated" cost-of-living rise that they deduced for 1937–69 from comparing the $30 tax with the maximum ultimate tax under present law both raises a question as to the appropriateness of this procedure and suggests that the ultimate taxes under the original and present laws should have been compared. This procedure yields a figure of about $2\frac{1}{3}$ instead of "more than seven."

Mr. Peterson lists certain points of dissimilarity between private insurance and social insurance as prepared by Dr. Robert M. Clark. In general, this is an excellent comparison except that the eighth characteristic of social insurance, "Investment solely in government bonds," is applicable to OASDI but not to all social insurance systems throughout the world.

The author gives a recommended statement describing OASDI and giving what he believes to be its differences as compared with individual insurance and private pension plans. In regard to the latter, his points (*a*) and (*b*) are equally applicable to both private pension plans and OASDI if, as I believe essential and logical, employer OASDI contributions based on a given individual's wages are *not* considered to be solely and completely for his benefit. After all, in a private pension plan the employer's cost is often expressed as a percentage of his total payroll, but this certainly does not mean that the employer contribution toward the benefit for every employee is the same percentage of wages.

Finally there is available a very excellent description of the historical development of the financing system of the OASDI program and the very strong financial controls that are built into it. These are contained as appendixes to our *Actuarial Study No. 49*. I can say that these are excellent because, as he pointed out, he and his colleagues developed this material, and the Social Security Administration staff merely did a little editorial work on it.

A. M. NIESSEN:*

Mr. Peterson's thought-provoking paper critically examines the method of financing used by the social security (OASDI) and railroad retire-

* The opinions expressed in this discussion do not necessarily reflect the official views of the Railroad Retirement Board.

ment systems. The author analyzes the situation from the point of view of traditional pension funding theory and finds it highly unsatisfactory. The railroad retirement program receives a good deal of special attention because it is held out as an example of how bad things can get. The impression is given that OASDI may be expected to follow the dangerous path traveled by its smaller companion, the railroad retirement system.

While no one in particular is directly blamed for the presumably bad situation which has developed, the paper strongly hints that a good part of the trouble may be due to a lack of understanding of the basic issues on the part of the general public. The description of the method of financing given by the agencies involved is found by Mr. Peterson to be incomplete and to a large extent misleading. To emphasize this point, the author proceeds to recommend exact language for a statement which would present an "accurate image" for OASDI and probably also for railroad retirement.

The problems discussed in the paper are extremely weighty and complex. They may be examined from different points of view and the solution would, of course, depend upon the point of departure. Furthermore, the problems of the railroad retirement system are not necessarily the same as those of the social security system. As Mr. Peterson points out, much has already been written on the subject and much more will undoubtedly be written in the years to come. Of course, the basic question is whether private pension fund philosophy is equally applicable to social insurance plans such as OASDI and railroad retirement.

This discussion does not propose to present a dissertation on the merits or shortcomings of the present social security and railroad retirement programs. Neither do I intend to go into an evaluation of the general premises which seem to underlie Mr. Peterson's analysis. All I propose to do at this time is to comment on certain of his statements which directly pertain to the railroad retirement system and its actuarial service. The comments are primarily factual, but occasionally a remark of a general nature is made for the purpose of clarification.

First I wish to state that the actuaries of the Railroad Retirement Board have always given the public all the facts needed for an intelligent appraisal of the actuarial condition of the program as it stood at the time of a particular valuation. This is a fact generously acknowledged by Mr. Peterson himself, as well as by many others. Speaking for myself, I do not believe that it is the function of the Board's actuary to specifically discuss such questions as "the contributor's willingness and capacity to pay" or "the principles of equity between individuals and generations." The reason I am saying that is that the answers to these questions hinge on a variety of considerations, most of which are not actuarial in nature. The actuary's obligation is only to disclose all facts which would enable the interested parties, as well as outside observers, to examine the situation of the railroad retirement program from whatever angle they choose. This the Board's actuaries have done and apparently with considerable success, as evidenced by the very serious concern for the actuarial soundness of the program shown by the Board, railway labor, railway management and the Congress.

Mr. Peterson recognizes the fact that the line between employee and employer contributions has become "less well defined" than it used to be before the emergence of large negotiated pension plans. This does not prevent him, however, from asserting that it is intrinsically wrong to have in the railroad retirement case equal contributions by both sides. Elsewhere (*Journal* ASCLU, Spring 1959) Mr. Peterson says that "the required contribution rate for [railroad] employees is simply too great," thereby implying that railroad employers should contribute more than one-half of the total cost and employees less than one-half. I find it difficult to reconcile the concern about the formal distribution of contributions with an awareness that higher employer contributions may not necessarily result in a substantial advantage to the employees except perhaps for small savings in federal income tax.

Following up on the question of distribution of costs between employers and employees, Mr. Peterson quotes from Mr. Robert J. Myers' *Actuarial Study No. 40* an opinion that "the eventual contributions [for OASI] should not be so high that young entrants could purchase more protection with their own contributions from a private insurance company." He also refers to an opinion expressed by Messrs. Murray W. Latimer, the former chairman of the Railroad Retirement Board, and Russell R. Reagh, former member of the Board's Actuarial Advisory Committee, that "the danger point would be reached if the scale of benefits indicated a required level of tax rate as high as 160% of the normal rate," a point reached when the new entrants are called upon to contribute 80% of the normal cost. Following these citations, there is a table purporting to show that the railroad retirement system will in a few years "have gone beyond the danger point cited by Messrs. Latimer and Reagh."

I can well understand the practical value of the criterion given by Mr. Myers, although reasoning from a different point of view one might say that the compulsory membership in the OASDI or railroad retirement system is worth a great deal to the employees since otherwise they would have in all likelihood been left without worth-while retirement protection. After all, annuities are very expensive and their widespread purchase on an individual basis cannot be taken for granted. Thus, it might well be argued that employees are better off under compulsory coverage, even though the cost to them is the same as it would have been under voluntary individual annuity contracts. In reality, the normal cost for the railroad retirement plan has been and still is far below the private company cost, as can be seen from the table below. Furthermore, Mr. Peterson's table does not portray the proper relationship even according to the stricter and, to my mind, rather arbitrary criterion of the new entrants' contributions not being more than 80 percent of the normal rate. What Mr. Peterson used was the actual tax rate in particular years instead of the level rate as indicated by the valuation applicable to that period. The ratios which I would consider proper under the "80 percent" criterion, also shown in column 6 of the accompanying table, indicate that the actuarially

Valuation as of Dec. 31	Normal Cost* (1)	Required Level Rate* (2)	Private Insurance Cost*: Annuity at 65 Alone† (3)	Private Insurance Cost*: All RRA Benefits‡ (4)	Ratio ½ of Col. (2) to Col. (4) (5)	Ratio Col. (2) to Col. (1) (6)	Ratio Shown in Paper (est.) (7)
1938	5.59%	10.80%				193.2%	98.4%
1941	5.77	10.21				176.9	104.0
1944	5.20	8.99	8.21%	10.34%	43.5%	172.9	130.0
1947	7.87	12.72	9.86	15.83	40.2	161.6	146.6
1950	7.66	13.41	11.33	18.95	35.4	175.1	156.7
1953	7.99	14.13	10.93	17.22	41.0	176.8	156.4
1956	8.39	15.75	12.04	19.23	41.0	187.7	149.0
1959 (est.)	9.60	17.81	12.88	20.47	43.5	185.5	140.6 to 187.5

* Percentages of taxable payroll.

† Monthly annuity based on maximum creditable earnings and 40 years of service with monthly premium for such an annuity equal to amount presently charged by one large company for a nonparticipating age 65 life annuity issued at age 25.

‡ Percentage cost Col. (3) multiplied by ratio of total normal cost to portion applicable to employee annuities payable after age 65.

required rate of contribution has always been in excess of 160 percent of the normal cost. The 1959 amendments have not changed the ratio appreciably.

Mr. Peterson considers it significant that "in the legislative committee reports on the 1959 railroad retirement plan legislation, the contribution rate for new entrants [term probably used for the normal cost] was not mentioned and there was no evidence of any interest or concern." (He might have added that the actuarial cost estimates supplied to these committees did not show normal costs as a separate item.) This may be interpreted as a hint that the omission of normal cost figures was premeditated in order to avoid calling attention to a difficult problem. Actually, our cost estimates for the 1959 amendments were derived from the over-all cost figures of the seventh valuation, which already combined the cost for future entrants together with the cost for former and present employees. There was simply no need to develop separate normal cost figures and this is the only reason why such figures do not appear in the various Congressional documents or in Board publications.

Anyone interested in the normal costs for the 1959 amendments could have himself made a fairly good estimate of them on the basis of the detailed information which appears in the report on the seventh valuation. All the people who took an active part in the legislative proceedings which resulted in the 1959 amendments were quite well acquainted with all the intricacies of the railroad retirement program and had a great awareness of the implications of the actuarial figures. This holds true regardless of whether they supported or opposed the amendments. If these well-informed people did not concern themselves with the relationship between normal and total costs, it was probably because they must have felt that in a national retirement plan the question is not quite as important as it would appear to be from a private pension plan approach.

Mr. Peterson takes me to task for describing the railroad retirement method of financing as a "kind of frozen initial liability method accompanied by level-premium financing." He cites our "gross unfunded liability" figures which show rather terrific increases from one valuation to another. The problem of shifting substantial portions of the unfunded liabilities to OASDI under the financial interchange is disposed of with a general footnote. As it happens, however, the financial interchange modifies the unfunded liability figures to such an extent that Mr. Peterson's thesis loses most of its foundation. This can be seen from the figures in the accompanying table. It is no accident that the last time the Actuarial Advisory

Valuation	Unfunded Accrued Liability (Millions)	
	Before Adjustment for the Financial Interchange	After Adjustment for the Financial Interchange
Preliminary	$ 1,796	
First	3,388	
Second	3,615	
Third	4,330	
Fourth	7,383	
Fifth	10,475	$4,560
Sixth	12,637	2,801
Seventh	14,995	5,470
1959 amendments (estimated)	17,000	4,500

Committee made a comment regarding the steadily increasing unfunded liabilities of the railroad retirement system was in connection with the fourth valuation. This was before the financial interchange which made subsequent comments of this nature unnecessary.

When I described the method of financing the railroad retirement plan as "a kind of frozen initial liability" method, I used the words "a kind of" advisedly because I was aware of the complications caused by recurring amendments. What I meant to say was that, as of any valuation date, the costs are computed as if the frozen initial liability method were to apply from that date on. This is not the way things are handled in private pension plans, but the analogy with such private plans does not always carry over to the area of national retirement programs operating under the auspices of federal law.

The dissemination of actuarial information in places where it will do the most good is one of the most important functions of an actuary, be he in private or government employment. The actuaries of the Social Security Administration and the Railroad Retirement Board have, in my opinion, done an effective job in this area. The Railroad Retirement Board has even gone so far as to train a number of its employees in a popular version of the actuarial story. These employees in turn are called upon to explain to selected groups the need for adequate financing, the nature and purpose of the reserve, the current actuarial balance sheet, the consequences of proposed amendments, etc. There is also a special publication, entitled "The Railroad Retirement and Unemployment Insurance Systems" (1959–60 issue), which contains a rather extensive discussion of the selected actuarial problems in popular language.

A minor point mentioned here only for the record is that the phrase "employee representative" refers to officials of certain fringe railway labor groups other than the standard railway labor organizations. The number of "employee representatives" who are required to pay the full tax is now less than one hundred. Mr. Peterson was under the impression that officials of all railway unions are required to pay the full tax.

I wish to conclude this discussion by saying that I found Mr. Peterson's paper extremely interesting and very stimulating. I am grateful to Mr. Peterson for indirectly providing me with the opportunity to present to the Society certain facts and figures about the railroad retirement system which were not generally known before.

JAMES L. CLARE:

The author suggests that "a major study of our social security problems should include . . .

"Study of what part of our future national income may be soundly committed for the benefit of the older segment of our population. . . ."

I agree wholeheartedly.

In fact, I suggest that such a study should be the starting point for all investigations concerning any social security system.

If this were the case, we could have much more certainty that we were not putting our heads in the nooses of "overgenerous state programs" that promise more than future generations will be willing to afford.

I fear that the United States social security system already does make such promises, especially since the latest amendments incorporated the thesis that benefits to all beneficiaries should be increased in line with rising living costs.

If the author had factored inflationary influences into his estimates as presented in this paper, his results would have been even more alarming.

I suggest that as actuaries we should be concerned to see that no promises are made that can not be honored—at the very least in terms of dollars and cents, and preferably in terms of real retirement security (as measured in goods and services) as well.

One of the costliest promises of the social security system is normal retirement at 65 for men and 62 for women. This is no newly "anesthetized" item: there has been anesthesia with respect to a retirement age that can be "afforded" right from the very beginning of the system clear up to the present day. Such discussion of the normal retirement age for the United States social security system as I have been able to trace was most cursory and superficial, and age 65 was taken for granted with (apparently) hardly a moment's earnest thought being given to this very major cost determinant.

What happened was the following. Age 65 was taken for granted. Taxes were set at levels which were then "politically acceptable." The levels of the benefits were the outcome of these haphazard decisions.

Since then, there has been an upwards pressure on the levels of benefits that has proved irresistable. Scheduled taxes have risen sharply, and may still be optimistically on the low side of what will eventually be needed if there is inflation in the future, or if benefits are liberalized yet further.

These highly probable tax increases over and above those already scheduled, and all the dangers they bring with them as demonstrated in this paper, could be avoided (or at least mitigated) if the normal retirement age were to be reconsidered and raised suitably.

I realize, of course, that all beneficiaries do not go on the rolls on their normal retirement date. But the possible economies from postponing retirement beyond the normal retirement date serve to reinforce the arguments I am now making, and also point up the possible need for making postponed retirement beyond the normal retirement date more widespread by deliberately introducing incentives to encourage postponed retirement into the social security system and into our society.

I suggest that the warnings of this paper are too urgent and too cogent for actuaries to shut their eyes to this matter of the normal retirement age any longer. I therefore suggest that the paper give rise to action along the lines of the following three questions:

1. How much will future generations willingly contribute to social security?
2. How large a pension is required to fulfill the "floor of protection" objective?
3. Stemming from 1 and 2, what normal retirement age can we "afford"?

JAMES A. ATTWOOD:

In his poignant and timely paper Mr. Peterson makes many comments and observations about the financing of our social security system. These remarks concern just two of his observations:

1. He points out the grave misunderstandings of the nature and implications of our present social security financing structure on the part of the public, the press, our elected governmental officials, and our career civil servants. He questions whether we are headed toward serious future problems because of these misunderstandings.
2. Mr. Peterson also wonders if the work of the actuary is being used as a soothing agent tranquilizing a legitimate concern about the future of our social security system. He points out that the soundness of the financing of this system extends beyond considerations of "actuarial equivalence" and "actuarial balance" of contributions and benefits. He challenges us, as actuaries, with the responsibility "to make clear to the public the limitations of the significance of actuarial calculations."

This is an appropriate and timely challenge. There appears to be ample justification for Mr. Peterson's concern over the widespread lack of understanding of the financing of our social security system. The tools and terminology of the actuary may be partially fostering this misunderstanding. In the main, this results from lack of public understanding of the significance and limitations of such tools and terminology.

Mr. Peterson suggests, in conclusion, that a major study of our social security problems should be undertaken by the best qualified individuals in the United States. Certainly we cannot disagree with this suggestion. However, are there activities which actuaries, individually and collectively, might undertake to help create better understanding pending, or in addition to, the establishment of such a high-powered study group?

The following possibilities are suggested for consideration:

I. *Individual Activities of Actuaries*

1. *Improve the understanding of our policyholders and clients as to the nature, significance, and limitations of actuarial computations.*

There is no doubt that our work in private pension plans establishes our role in pension security programs. It also sets an example for what the public might logically expect from actuaries in connection with the pension benefits of our social security system.

Perhaps we ought to examine the image in the minds of our policyholders and clients of the role of the actuary in private pension plans. The more appropriate this image, the more likely that the *total* public will understand better the nature of our work, and the significance and limitations of actuarial computations.

In many instances, our work and the significance and limitations of our calculations are substantially or fully understood. However, there are situations where considerable misunderstanding exists. This usually results from apathy of policyholders and clients. Sometimes, however, they may be led to believe that actuarial computations are too complex to understand. Understanding is discouraged when we say: "Accept these results; they're actuarially sound. You don't need to understand; they're too complex."

When we do this we establish the image that actuaries are judge and jury as to when something is or is not sound. Is this the image we should create? Is this the image we want the public to accept? Is this the image that appears whenever an actuary gets involved with social security?

The legend of "actuarial soundness" often gets into pension plan documents, actuarial reports and certifications. Is it any wonder that many people expect the actuary to be able to determine and validate actuarial soundness? The reader of an actuarial report often looks only to see if the actuary says, "The plan is actuarially sound." Such a generalization becomes a tranquilizer, dulling legitimate and healthy concern which the reader should have about the nature, limitations, and significance of actuarial calculations. If this happens in our work in private pensions, it certainly is likely to happen in the social security area.

There is considerable room for improvement of the understanding of our policyholders and clients. Better understanding of the nature of our work, and of the significance and limitations of actuarial computations, in addition to its salutary effects in private pensions, will create an expanded body of people available to educate the general public.

At the minimum, our policyholders and clients should understand:

a) the difference between outlay or contributions to a plan and its ultimate or long-run costs;

b) the factors which influence ultimate costs and the factors which influence outlay or contributions;

c) the actuarial assumptions, methods and techniques available and the reasons behind the particular selections made;

d) the advantages and disadvantages of advance funding; and

e) considerations involved in determining the rate of advance funding.

2. *Improve our understanding of the nonactuarial factors involved in the soundness of both private and public security programs.*

Mr. Peterson has appropriately pointed out that the problems of social security financing extend beyond actuarial considerations. He raises a number of social, political, and economic issues. Certainly actuaries cannot operate in a vacuum. We must be cognizant of many nonactuarial factors and concepts in order to make our role more effective and better understood.

This is true both in private and in public security programs. The actuary in private pensions must, of course, serve his policyholders and clients with the competent discharge of his technical responsibilities. However, the actuary has not sufficiently met his responsibilities if he fails to consider the effect and relationship of his actuarial computations on the successful operation of the business of the employer involved. This involves consideration of the financial, organizational, employee relations, and other policies of the employer to whom he is responsible.

There is no one right answer about actuarial funding which applies to all employers. The appropriate funding pattern for a particular employer must be determined by coordinating the actuarial considerations with the nonactuarial factors. A heavily funded pension program certainly cannot be good for an employer if it jeopardizes the success of the organization. Continued existence of the organization has a much greater economic effect upon its employees than the value of conservative soundness of their pension plan. On the other hand, the actuary must always be careful that his calculations are not being used, either inadvertently through lack of understanding or deliberately for other reasons, to obscure the significance of the obligations incurred, or to pass on to future generations of management, stockholders, and employees an obligation they may not be willing or able to undertake.

Mr. Peterson points out past examples of ineffectiveness of actuaries in influencing public opinion and governmental decisions in the public pension area. Perhaps this results from our lack of training to recognize the importance of nonactuarial considerations. Our success in influencing public opinion is directly dependent upon our ability to relate and coordinate competent, technical performance of actuarial responsibilities with the practical social, political, and economic problems which face private employers and the government. When we do this ably, our work will be better understood and more constructively used.

3. *Participate actively in the public debate*

As citizens with specialized knowledge of the structure of security programs, actuaries have a major public responsibility to study social security problems, propose solutions, and participate in their consideration. This involves keeping ourselves informed as to what is going on and making our ideas known to our governmental representatives.

There are powerful forces among the so-called "social planners" who are constantly at work. These people are dedicated to seeing that the security needs of the people of our country are met. As to the means to meet these needs, their thinking often is unclear. This group has a powerful effect upon public opinion. There is need for an effective force to check and moderate them.

Our affiliation with private pensions and insurance, of course, reduces somewhat our effectiveness in directly influencing public opinion on social security problems. This results from the implication that our feelings reflect our special interests, rather than concern for the public interest. For example, at my request Mr. Peterson's paper was read by several people not occupationally engaged in work connected with pensions and insurance. All of them felt it was unfortunate that the value of his excellent paper is diminished by the references to the threat of social security to private pensions and insurance.

II. *Collective Activities of Actuaries*

It is logical to question whether there are some collective activities of actuaries, perhaps through the Society of Actuaries, which could be undertaken to improve the public understanding of the work of the actuary—his techniques and terminology and the nature, significance, and limitations of his results. The Public Relations Committee of the Society of Actuaries, or a new special committee, might consider some of the following possibilities.

1. Analysis of the existing image of the work of the actuary in public and private pensions. This might involve the use of an outside opinion research firm.
2. Establishment of a mechanism through which actuaries may make their thoughts and opinions known and consolidated, perhaps with the eventual result being a published statement by the Society of Actuaries as to the nature, significance, and limitations of actuarial computations—both for public and for private security programs.
3. Writing of books and articles about the work of the actuary. These would be written in popular style, intended for public consumption.

Mr. Peterson's paper is a landmark which should stimulate us better to understand our own work and responsibilities.

JOHN HANSON:

Mr. Peterson's observations certainly did stimulate considerable interest on the part of at least one of the younger members of the Society of Actuaries. After a first reading of his very persuasive paper, my initial reaction, as a member of a younger generation, was: "Gentlemen, you can't do this to me."

Indeed, the apparent lack of interest in equity between generations which is suggested by the deaf ears turned to actuaries' pleas for what they know to be sound principles of pension financing is appalling. Among those anesthetized, judging from Mr. Peterson's paper, are: the executive branch; the Congress in general and Senators Keating and Proxmire in particular; *Time* magazine; *Newsweek; U.S. News and World Report;* and the *Wall Street Journal*. It is surprising that, from such a cross section, no voice is raised questioning the possible consequences, to a future generation, of a lack of actuarial balance. Is there truly no concern with the legacy to the future, or have the actuaries' arguments been ignored for a different reason?

After reflection, my reaction is considerably less militant, and I feel that the failure of contemporary thought to evidence more anxiety about the condition of the governmental pension funds may, after all, be reasonable.

Why so? Certainly not based on the merits of the issue, as evidenced by statistics stated by Mr. Peterson. He observes that, under the OASDI system prior to the 1958 amendments, present entrants may anticipate benefits with a level-premium value equal to only 4.93% of payroll whereas payroll taxes with respect to themselves are valued at 8.30% of payroll. This is especially alarming since past history indicates the likelihood of future changes under which the new entrant may receive benefits worth less, in terms of purchasing power if not of dollars, than his own contributions. (The danger inherent in passing along costs to the next generation is considerably more real to persons, such as myself, who believe inflation is avoidable, than it would be to persons who feel that moderate inflation is not only unavoidable but desirable. Such persons, I am sure, would introduce the perception of decreasing purchasing power into their interpretation of the above statistics and, anticipating future benefit increases, would wish to revise Mr. Peterson's suggested image of social security financing: as a minimum, they would object to the statement that the value of the employee's contributions alone will *be close* to the value of the benefits.)

Notwithstanding my parenthetical comments, I do not feel that contemporary thought can be characterized as reasonable based on the *merits* of the specific issue of pension funding. The reasonableness rather is based on the *relative merits* of the issue. For, financing of governmental pensions is not, at least in my opinion, one of the fundamental problems of our time, although the possibility of a potential charge against a future generation resulting from the funding of governmental pension schemes may be extremely important as a symptom of an unsound national fiscal policy, which could be fatal.

The ideal legacy from generation to generation would be a stable currency. This would indicate to me (1) that there would be no major wars, (2) that there would be moderation on the part of all persons and groups whose actions touch on the public interest, and (3) that there would be no further increases in the national debt. Passing along such a legacy might also indicate that the social security financing system would be sound in all respects, but perhaps not. If a balanced budget could be achieved, year in and year out, I, for one, could tolerate some inequity between generations in the social security system. For example, a deferral of pension cost at this time undoubtedly seems justified to many persons because of the country's extensive financial commitments to defense and foreign aid, at least under the hopeful assumption that better world conditions will prevail in the future. The President may have had this in mind when he refused to add to a $12 billion deficit in order to bring the civil service retirement system up to actuarial snuff. If I had had an individual choice between expending $589 million on the retirement system to meet "full normal cost plus interest" or on a scientific or military project, I believe I could have chosen more than one alternative which I would have believed to be of greater importance to my progeny.

But let us assume for discussion that the same part of the national productivity must always be committed to defense and foreign aid, *i.e.*, that an increased social security cost for the next generation cannot be justified because of the fantastic military expenditures at this time.

Under this assumption, the fundamental problem and greatest danger is inflation itself, and defects in the social security financing system may be nothing more than symptoms of inflationary practices and thinking. The advisory council on social security financing declared that "the defeat of beneficiaries' expectations through inflation would gravely impair the stability of our social, political, and economic institutions." Among sources quoted by Mr. Peterson, there is apparently agreement that inflation can destroy the social security system, and only a feeling that the social security system may, or could, contribute to inflation. My own guess is that social security could indeed contribute, but whether it is a major factor is questionable. In short, I am not now persuaded that, in Mr. Peterson's vicious circle, Step (3) must necessarily result from Step (2).

It is not my purpose to disparage the subject of this paper, which is a proper subject for actuarial review, but to comment on what I think is a proper perspective. Although a study of social security benefit levels and financing is undoubtedly in order, a major effort to understand and control inflation seems even more important. If the "man in the street" demands a balanced budget and an end to inflation, need we then worry about a correct image of social security financing? When the people, the Congress, and the executive branch do not demand (or even mention) payment against the principal of the national debt, can we make a convincing argument for amortization of what we describe as an unfunded past-service liability?

Thus, it is my feeling that a review of the social security financing system should be only a part of a major study of cause and control of inflation. A study of only the social security system would be a study of only a part of the problem—a procedure to be contemplated, perhaps, only by anesthetized actuaries.

A study of inflation would necessarily cover many of the subjects suggested by Mr. Peterson for his study of the social security system. Specifically, considerable effort would be justified in determining the best way by which a correct image of the effects of inflation may be presented to the "man in the street." Restating the problem, in what way can the "political environment" be changed so that it becomes unpopular to advocate inflationary measures?

The President has stated that only public opinion can keep the dollar sound, and that the alternative is economic dictatorship. Can the insurance industry perform a public service, and a service to itself, by encouraging policyholders both to believe in a sound dollar and to write their congressmen each year to create a public demand for sound fiscal policies? Can premium billings be made to serve a purpose in addition to the function of collecting dollars? Such a campaign could, perhaps, be modeled on the "clip-out" approach of the Chicago *Tribune.*

The federal income tax and its relation to inflation would be another proper subject to study. Specifically, what is the effect of the present progressive income tax, with its confiscatory rates on top income, on incentive and productivity and therefore on the ability of the nation to grow. Mr. Peterson asks if the tax-exempt status of social security benefits produces effects that "resemble" regressive taxation. It is easy to agree that there is a resemblance, but the resemblance is unnatural since the elimination of the progressive income tax itself would eliminate the regressive resemblances.

SHEPHERD M. HOLCOMBE:

I should first like to compliment the author on presenting a comprehensive paper to our Society. I feel that every actuary should read this paper to have a better understanding not of our social security but of government thinking behind it. It is only with such understanding that we as individuals may be able to offer our professional services to their fullest advantage.

From a personal point of view, I should like to make the following observations on the three government pension programs mentioned in Mr. Peterson's paper.

Civil Service Retirement Plan

In my mind the civil service plan is based on an employer-employee relationship as is common in plans with which the pension business deals daily. The simple conclusion to this is that the government should consider itself as an employer and, to the extent that they are applicable, it should meet the normal Treasury Department requirements and should thereby maintain an adequately funded plan. As with a normal employer, it would presumably be logical for the plan to be funded on a self-insured basis or some form of insured basis. However, because of the numerous and changing personnel administering such a plan and the political expedients that could be adopted from time to time, I should like to submit that it may be more logical to handle such a plan on a fully insured basis. This would have the advantage offered by experienced insurance company administrators and technicians, would insure to employees that benefits accrued would not be lessened (to modify a quotation of the author: "with those insurance companies in there, no damn politician can ever scrap our benefits"), and would alleviate the time involvement of inexperienced government officials in such problems.

I appreciate that this could create something of a monster for the insurance industry to handle but I feel it could be worked out on a satisfactory pooled arrangement.

In regard to financing, the government might request that this be funded through government bonds and I see no reason why such a requirement could not be met by the industry, subject to any enabling legislation that might be required.

Railroad Retirement Plan

It seems to me that in this area the government is involved in a private industry plan where at this junction there is no reason for government involvement. I believe railroad employees should be covered under social security and that any additional benefits should be provided through some other means whether it be a common railroad plan, a union-administrated plan, or individual self-insured or insured plans for each railroad.

Old Age, Survivors, and Disability Insurance Program

There is a wealth of material going back for a number of years on our social security system and the thesis that I wish to present may, therefore, have been better said at some time in the past. However, I feel it worth emphasizing at this time.

In thinking of the social and economic development of this country, I questioned myself as to why we did not have some kind of social security system earlier. It appears to me that 100 years ago there was no such need. We were primarily living in an agricultural economy with not much population crowding. When people came to an age where they could not or did not care to work as hard as in their younger days, they could generally be accommodated by children in their farmhouse and occupy themselves with some of the minor duties of taking care of the chickens, sewing and baby-sitting!

With the development of an industrial system and the resultant crowding of the population into smaller areas, people getting to a retirement status could not move in with their children and many children found it impossible to maintain a separate residence for retired parents. Thus we have a logical climate for the introduction of social security.

On the basis of this thesis it is apparent that social security is a means by which the younger active generation can provide for the older retired generation. The obvious conclusion from this is, therefore, that the social security system should be operated on a pay-as-you-go basis, with a small fund built up to take care of any fluctuations in experience from year to year. This apparently is how it has been operated to a large extent. However, it seems that most of the people we choose to send to Washington go through considerable mental gyrations and a multitude of figures and projections trying to maintain the fiction that individuals will buy their own benefit. Then they end up in the same position to which the direct approach above would lead.

On the basis of the above thesis, it would seem that any relationship between the contribution to social security of any individual and the benefits he might receive is completely irrelevant since he is not making contributions for his own benefit. Nor is an accrued liability calculation relevant. The important projection necessary is to determine what level costs on a pay-as-you-go basis will be, so that we can be sure that such costs can be met by reasonable contributions.

The author has suggested that a statement presenting an accurate image of social security be added to the booklet "Your Social Security." I wholeheartedly endorse his idea and suggest that it be preceded by the following statement:

A hundred years ago if you wished to retire, you usually had some children living with you to take care of your farm or you could move in with them and be of some assistance in running the farm. Thus your children were largely contributing to your support after your retirement. Since those times, we have had what might be called a social revolution. People working in cities do not always have space to accommodate parents. In addition, a sense of independence and dignity on retirement have become very important. Also, because of better traveling facilities, a person on retirement will usually want to travel. To accomplish this, we have a social security system where each working member of our population pays a small amount in social security taxes to provide a basic minimum retirement benefit for the older generation.

Ideally, I believe that social security should provide basic minimum benefits and thereby should not be geared to earnings as it now is. Likewise, taxes should be a basic flat amount with perhaps some reduction for earnings under the basic minimum wage level. Such a system would help to emphasize the actual nature and intent of the social security program and its funding.

I do not feel that we can emphasize enough the basic philosophy that a social security program should provide only a basic minimum benefit. Company retirement programs today provide an additional amount and individual planning should be encouraged to provide any excess that an employee may wish to save for. We have a great country which was built by individual initiative so that the individual could reduce his insecurity. Providing too large a pension automatically will tend to eliminate any insecurity and thus reduce individual incentives.

CONRAD M. SIEGEL:

I should like to congratulate Mr. Peterson on the submission of a most thorough and thought-provoking paper. Mr. Peterson has very ably demonstrated the application of actuarial thinking to the social security system beyond the usual comparison of the possible equivalence of benefits and taxes in perpetuity. The serious shortcomings of the present system viewed in the light of the most desirable features of a soundly constructed social insurance system are well covered in the paper.

To this discussant, the principal area of danger lies in the continued liberalization of the benefit structure at the customary biennial interval. An excellent example of the forecasting abilities of actuaries in the political field, where accurate prediction is supposedly so very difficult, is found in the paper "Cash Benefits for Extended Disability" (*TASA* XLIX, 54) by Messrs. Grange and Miller, together with the fine discussion of that paper by Mr. M. A. Linton. Of several aspects considered, the "entering wedge" theory is of particular significance. As was suggested a decade ago by Messrs. Grange and Miller, as well as Mr. Linton, those in favor of the inclusion in the social security system of long term permanent and total disability benefits would attempt initially to install a minimal, restricted, carefully guarded benefit, anticipating that, after a short period of favorable experience possibly under healthy economic conditions, the Act would be amended to provide a full-blown, wide open, liberalized benefit.

Disability income benefits became part of the social security program as a result of the 1956 amendments to the Social Security Act. These amendments provided disability income benefits for those between the ages of 50 and 64 who were permanently and totally disabled and had been so for six months, provided the recipient was fully, currently and disability insured. The amount of the monthly benefit was equal to the primary insurance amount, reduced, however, by any other federal disability benefit and Workmen's Compensation payment.

The morbidity experience for the short period from the operative date of the 1956 amendments to the enactment of the 1958 amendments was very favorable relative to Mr. Myers' valuation assumptions (*TSA* XI, 1). Mr. Myers stated, in this paper, that he has not changed his basic valuation assumption in the light of the limited experience available. Nevertheless, it is very interesting to note the expansion of the monthly disability benefit provisions by reason of the 1958 amendments to the Social Security Act.

(1) The maximum wage base was increased from $4,200 to $4,800.
(2) The benefit percentages were increased by 7%.
(3) The maximum possible primary insurance amount was increased from $108.50 to $127.00, an increase of 17%.
(4) Dependents' benefits for permanent and total disability were added so that the maximum possible family monthly benefit was increased from $108.50 to $254.00, an increase of 134%.
(5) Currently insured status was eliminated as a requirement for eligibility for monthly disability benefits.
(6) The period for which retroactive disability payments may be made was increased.
(7) The benefit reductions because of other federal disability benefits and Workmen's Compensation benefits were eliminated.

When we consider that it took over twenty years for old-age and survivors' benefits to reach their present state, the "progress" of the monthly disability benefit in less than two years has been remarkable!

GEORGE E. IMMERWAHR:

Mr. Peterson has written a most thought-provoking paper. I also found it a most memory-provoking paper, and in submitting this discussion of it I cannot detach myself from the seven years (1939–46) spent on the staff of the Bureau of Old-Age and Survivors Insurance.

Mr. Peterson's subtitle "Actuarial Anesthesia" is unfortunate, because it might imply that the Social Security actuaries fell down on their responsibilities, whereas neither the actuaries of earlier years nor those who still remain with Social Security should be blamed for the misconceptions to which Mr. Peterson refers. During those earlier years, there was much contention between the economists who dominated the Social Security Administration and the actuaries who were imported from the Metropolitan and other life insurance companies to give the organization the aura of actuarial respectability. The economists insisted that the actuaries, being steeped in private life insurance theory, could never be expected to learn anything about social insurance. Yet it was a Metropolitan actuary, R. A. Hohaus, who set forth in his actuarial paper "Equity, Adequacy, and Related Factors in Old Age Security" (*RAIA* XXVII, 76) the principles upon which the 1939 and subsequent Social Security amendments were adopted, principles which incidentally met much initial resistance from this same group of economists, who could think only in terms of simple individual equity. For years after the adoption of the 1939 amendments, it was the actuaries in the Social Security Administration who tried patiently, but in vain, to teach the economists the very social insurance concepts which Mr. Peterson excellently sets forth in his paper as "an accurate image," namely that the method of financing of social security is fundamentally different from that of private insurance and pension plans, and that it can be rationalized only when its objective is to provide only a basic floor of protection which is related to presumptive need as measured by age, survivorship, and family composition.

Eventually, some of the actuaries came to believe that, just as the 1939 amendments were an improvement over the 1935 individual equity provisions, so a "social budgeting" system with flat benefits might be an even better adaptation of the principles of social equity and could permit sounder financing (see my remarks in *TASA* XLVII, 104–105) but these radical views never came to realization.

The economists argued then, just as their successors (such as Robert Ball, who is quoted by Mr. Peterson) argue now, that the social security taxes are *premiums* for the OASI benefits in just the same way as life insurance premiums are for life insurance. At one time, in fact, some of us were instructed to use the word "premiums" in lieu of "contributions" or "taxes" in written material going to the public. Some of us were not always obedient.

The fact is that to imply that OASDI benefits have been "paid for" by the contributions of the individual employee and his employer is an absolute deception and really serves to undermine the security of the OASDI program. This is particularly illustrated by the controversy over the work clause or retirement test. The Social Security Administration, aware of how much the abandonment of the work clause would cost and how much it would retard liberalization of benefit amounts, is still apparently supporting the work clause but is finding this task increasingly difficult while it is constantly claimed that benefits are "paid for" by individual contributions. Senator Douglas, for example, has been quoted as saying (see *The Christian Science Monitor*, September 17, 1957): "I'm in favor of eliminating completely the limit on earnings of OASI recipients. To require those getting OASI payments to give up gainful employment is, in reality, attaching a condition to insurance which they themselves have bought."

The fact is, of course, that the work clause does not limit earnings but merely makes it impossible for persons under 72 to get full earnings and full benefits at the same time. Rather than decreasing productivity of older persons, the work clause actually serves to maintain productivity, since most people who are still able to earn substantial amounts will be induced to do so rather than go into partial retirement.

I have often felt that rather than go out of their way to tell people erroneously that their own individual contributions have paid for their benefits, the Social Security people would be much wiser in pointing out what a small proportion of their OASDI benefits have been paid for in this way. I would actually recommend that with the award letter to every new primary beneficiary should go a statement such as the following:

It is important that you realize that this benefit is being awarded to you as your legal right under the Social Security laws, but that it is subject also to the legal restrictions and conditions imposed in the same laws. Moreover, it may be either reduced or further restricted in the event of a change in these laws.

Your benefit is not a contractual right as would be an insurance or annuity benefit purchased from a life insurance company. In the case of a benefit purchased from a life insurance company, the premiums one pays all go toward the purchase of the benefits for all those in a given classification (such as all of a certain age) and all the benefits paid to members of that classification are intended to be financed solely by premiums for that classification. This is not true, however, in the case of the OASDI primary benefits you are about to receive. Your own social security taxes paid under the Federal Insurance Contributions Act, even when increased by the like taxes paid on your behalf by your employers, in all probability paid for only a very small proportion of your benefits. For example, if you were continuously employed in covered employment since January 1, 1937, and had paid in maximum taxes ranging from $30 a year in 1937–49 to $120 for the year 1959, if you are only 65 today these total taxes could have provided a monthly benefit of only $15.38; and if you were not continuously in covered employment or did not pay maximum taxes throughout this period, the monthly benefit your taxes have purchased would be much less. This disregards the fact that you have already enjoyed life insurance protection under the OASDI program and will continue to enjoy it, and that the cost of this insurance protection alone would have consumed much of this tax money. In fact it is estimated that the total combined taxes paid by all persons born in 1895 and those paid by their employers on their behalf will be more than exhausted by personal and family benefit payments made on account of this year-of-birth group by the end of the year 1962.

This does not mean that your OASDI system is insolvent. Instead it means that its solvency depends not on the tax money it has already collected, but rather on the ability to continue to impose social security taxes in the future on the millions of younger people who are still at work, and it therefore depends in great measure on the future productivity of these younger people. Their OASDI benefits in turn will depend on the future productivity of still later generations. The solvency of your OASDI benefit system also depends upon the right of Congress to impose conditions (such as the suspension of benefits in certain cases of your future employment) necessary to prevent the tax burden of others from being unduly high.

It is only on this basis that the American people are able to provide you with benefits so far in excess of what you yourself have purchased with your social security tax money. It is only on this basis that the American people will be able to supplement your own old-age benefit with benefits to possible dependents and survivors, if legally qualified. Finally, it is only on the basis of future increased productivity of the American people that any increase in these benefits (measured in terms of purchasing power) can possibly be expected.

The $15.38 monthly primary benefit mentioned above represents the maximum a 65-year-old person could have purchased as of January 1, 1960, with only his own contributions, and is in contrast to the $119 benefit such person would actually receive. The $15.38 is based on the 1949–51 U.S. Male Table with 3% interest. It ignores all dependents', survivors', lump-sum and disability benefits, and is based on accumulating employee contributions with full benefit of survivorship.

GEOFFREY N. CALVERT:

I should like to congratulate Ray Peterson for a splendid contribution to actuarial thinking. What he has said has long needed to be said. He has rendered a great service to the actuarial profession and to the public.

Not only has he dealt with matters of tremendous importance, but he has in dealing with them shown a breadth of scholarship and a clearness of style which will place this paper easily within the grasp of many who would otherwise find the real fundamentals of this subject difficult to understand.

He has pointed out the tremendous public confusion which exists relative to the fundamentals of the Social Security plan and has called for a clearing up of public thinking. He has also called for a study in depth of the social and economic impact of the plan and particularly its funding method. With both of these thoughts I strongly concur.

In furtherance of his thesis relative to public confusion, it is highly instructive to place alongside each other the following statements, issued by or apparently concurred in by the U.S. Department of Health, Education, and Welfare:

The First Voice (for public consumption):

If your work is covered by the social security law, you make social security tax contributions during your working years *in order to* provide an income for yourself or your family in case your earnings are cut off by old age, disability, or death. [Italics supplied.]—"Your Social Security," Form OASI-35, November 1956.

During working years employers, their employees, and self-employed people pay social security taxes which go into *special funds* and . . .

When earnings have stopped because the worker has retired, or died, or is disabled and is 50 years of age or over, benefit payments are made *from the funds* to replace part of the earnings the family has lost. [Italics supplied.]—"Your Social Security," Form OASI-35, January 1959.

Second Voice (for Supreme Court consumption):

The OASI program is in no sense a federally-administered insurance program under which each worker pays premiums over the years and acquires at retirement an indefeasible right to receive . . . a fixed monthly benefit. . . .

The contributions exacted under the . . . program is (sic) a *tax*.

Unlike private insurance . . . the social security program needs no such reserves since it is assured of continuing participation by the exaction of taxes.

. . . the social security concept is of a program under which those with jobs in their productive years, their employers, and persons engaged in self-employment *are taxed* chiefly to provide the funds *for current benefits* to aged beneficiaries and other eligible survivors. [Italics supplied.]

Consistent with the non-contractual nature of OASI benefits is the ruling of the Internal Revenue Service that monthly benefit payments are *voluntary payments* to the recipient by the government . . . and hence within the scope of . . . (a section) . . . exempting from taxation the value of property acquired *by gift*. . . . [Italics supplied.]

. . . a belief has developed . . . that title II benefits are paid as the result of a contractual obligation on the part of the United States Government. . . . This belief has been fostered to a considerable extent by publications and other statements of responsible officials of the Social Security Administration. Testimony . . . in the 1953 hearings clearly established that there is no contract. . . . Heretofore, these facts and their implications have not, for some reason, been conveyed to the public.—Brief for the Appellant (signed, among others, by the U.S. Solicitor General) in the case of Arthur S. Flemming, Secretary of Health, Education, and Welfare *v.* Ephram Nestor, Supreme Court of the United States (October, 1959).

First Voice (for public consumption):

Beginning January 1, 1960, 50¢ more social security tax on every $100 you earn (and 50¢ more from your employer) . . . provides:

Monthly payments for *you and your family at retirement*, or when you are between age 50 and 65 and severely disabled.

. . . for more information on your *rights* and benefits see your social security office. [Italics supplied.]—U.S. Department of Health, Education, and Welfare Form OASI-54, November 1959.

When statements as self-contradictory as these are issued by or collaborated in by the *same* government agency, it is certainly time for the public to take an interest in what is going on. If the whole social security system is merely a "tax and give away" system, why not tell that to the public? If the employee really acquires "rights" for himself and his family by contributing, why not tell that to the Supreme Court?

It would seem to me that the term "social insurance" itself is in need of clear definition, and that the words "insurance," "fully insured," "currently insured," "rights," etc., in connection with the OASI program are highly misleading as they are being used.

There are many who feel that the issuance of statements of this nature to the public, while extracting payments out of them, does indirectly create the basis of a contract. It creates the understanding on the basis of which payments by the public are being made.

To follow for a moment the playful use of words in Ray Peterson's own fashion, we may ask: Would the public be offended if the administration contended or even pretended it has not extended but has merely attended to benefits intended?

Reverting to Ray Peterson's other main proposal, which is to have a proper study made of this whole matter, I believe that this proposal will stand on its own merits and should receive the strongest support from the actuarial profession.

M. ALBERT LINTON:

Mr. Peterson has rendered a useful service by bringing into the open a number of aspects of our social security system which have not received the attention they deserve. In particular he has focused attention upon the relation between the payroll tax rates and the rates needed to provide the benefits of the system for young entrants. Because the present generation of workers is not making advance provision for its own future benefits an added burden is being passed on permanently to the workers in the years to come. Accompanying this principle there is a reasonable theory that the payroll tax rates to be paid by employees as a group should not exceed the value of the benefits they are to receive. The matching taxes to be paid by employers are therefore to be looked upon as being at least large enough to meet the added costs the present generation is passing on to the succeeding ones.

Before discussing this theory I would comment on the matter of passing on costs. This concept is likely to be confusing to the layman. He is apt to think that the problem is a transitional one, and that in the course of time the situation will right itself after the present generation of pensioners has passed on. Actuaries, of course, know that it will not right itself, but the reason is not clear to the uninitiated.

The essence of the situation is that the only way a given generation of workers can make advance provision for their benefits is for them to pay taxes sufficiently large to create a reserve fund which will produce adequate interest to be used by the succeeding generations in making pension payments. However, no generation is likely to create such a reserve. One reason is that it is using its taxes to pay benefits to those already on the rolls and does not want to pay more for reserve purposes. Because the reserve is not being created, the system will never be in balance in the sense that benefits and expenses would be covered by taxes levied at rates for young entrants computed on an actuarially sound basis. The reserve fund that has not been created in our social security system is of the order of $300 billion, on which at, say, three percent the interest yield would be $9 billion a year. Since there is no chance that we shall create any such reserve, the burden being passed on to the future is permanent, with nothing transitional about it in the sense that the situation will right itself in the course of time. A glance at the estimates of the amounts of future benefit payments and their relations to payrolls should dispel any doubts on that score.

It may be noted in passing that it is difficult to create even modest reserves in tax-supported programs. This has been demonstrated by experience with the railroad retirement and civil service retirement systems. Congress simply refuses to appropriate the money to provide needed reserve funds. The legislators see (1) a substantial surplus of income over outgo and (2) a reserve fund of a few billion dollars. To them that is sufficient to indicate that everything is all right. They take a dim view of extra taxes imposed simply because actuaries wave red warning flags about the future. Given time, perhaps the problem will go away. Or if it doesn't, let the future worry about it. In the meantime benefits are paid and promised on a level actuaries know will be a headache in the future.

When the social security system was set up in the 1930's the building of a relatively large reserve was actually contemplated. However, it soon became obvious that the plan would not work. The rates of payroll taxes practicable in the economic and political climate of that day were not adequate to pay reasonable benefits to those emerging as pensioners and at the same time to permit the system to operate on what came to be known as a "full reserve" basis. Under the plan the more adequate benefits would not have been available until the distant future after the fund had been created. Consequently the Congress in 1939 followed the recommendations of an Advisory Council and provided larger benefits for the earlier years of the system and reduced them for the long distant future. If something like that had not been done, the contributory principle would have been replaced by a system supported by some kind of general tax.

Another consideration against continuing the full reserve plan was the fact that the contemplated reserve fund would have been of a size comparable with the then existing national debt. Government bonds were obviously the only acceptable investment for the reserve fund, unless the country were going into national socialism by investing in productive activities in competition with private business. Faced with this set of circumstances, the decision was made to change to a pay-as-you-go basis, collecting only enough excess taxes to build a contingency reserve of modest proportion to serve as a stabilizer in times of fluctuating tax receipts and benefits. Incidentally, by coincidence, the true reserve liability under the system as it stands today is comparable in size with the present national debt.

Let us return to the theory that the employees' payroll taxes in the future should not rise above the true rate for a new entrant; and that the employers' taxes should make up for the interest that would have been received from an actuarially adequate, but nonexistent, reserve fund. Is that going to cause trouble as the payroll tax rates advance to their ultimate level in 1969 of $4\frac{1}{4}$ percent each on employees and employers, excluding the $\frac{1}{2}$ percent disability tax? Corresponding to this $4\frac{1}{4}$ percent rate the computed rate for new entrants is close to 5 percent. The theory thus leaves a $\frac{3}{4}$ percent margin in favor of the new entrants.

However, it may be exceedingly difficult, probably impossible, to hold the benefits at their present levels as the tax rates increase in four steps from the present rates of $2\frac{1}{4}$ and $2\frac{1}{4}$ to $4\frac{1}{4}$ and $4\frac{1}{4}$. The average man does not understand the need for increasing tax rates for a stationary benefit level. He expects the two to advance together. Politically it pays to come up to the expectation. We may therefore reach the point, as Mr. Peterson has suggested, where the employees' tax rates will exceed the true rates for new entrants. Without any change in benefits this situation will actually occur for higher paid employees, and even sooner for the self-employed who pay one-half as much again as employees.

Even with the situation as it is today, the theory we have been discussing may encounter resistance. Taxes paid by employers enter into their costs and are reflected in prices. This, of course, reduces real incomes so that in effect the workers pay indirectly a substantial part of the social security costs supposedly being borne by employers. Struggle as they will, there is no way by which the future generations can avoid paying the extra burden we are passing on to them, unless they actually reduce benefits. If they attempt to shift the burden to general tax revenues they again may simply push up prices; or they may impose taxes in such a manner as to place a dangerously heavy burden upon the economy of the country, already overburdened with defense and other vitally needed expenditures. An essential for a secure national pension plan is not only a sound method of operation but also a sound economy. Excessive social security burdens could undermine the foundations supporting not only social security but many other operations in the country, public and private. We are dealing therefore with an extremely important problem.

What then can we do about it? For one thing we can individually help to spread a knowledge about the workings of the social security system. It is important that people should understand the way we are passing a heavy burden on to the future. Because of this burden, anticipated benefits may not be as secure as is generally supposed. It is important to oppose liberalizations that would make the situation worse than it is already. As the tax rates rise there will be opposition, especially if the benefits are not also raised. Efforts may be made to shift some of the burden to general revenues. One small step in that direction would be to make the employees' social security taxes deductible for personal income tax purposes. This would save the employees money at the expense of the general taxpayers. Strong pressure has already been applied to have this relief granted to the employees in the railroad retirement system, as Mr. Peterson has reminded us. In due course efforts may be made to have the social security system subsidized directly from general revenues. The dangers of such a course have already been noted. All of this points to the necessity of confining the benefit load within safe limits. It has already exceeded the level for a basic floor of protection contemplated in the early days of the program.

Mr. Peterson has usefully called attention to the increasing proportion of dependents at each end of the age scale as compared with the producing group aged 25 to 64. This group is estimated to increase by ten million from 1955 to 1970, as compared with an increase of thirty million children and six million old people. Even with increased productivity through technological advances and large capital investment, there is likely to be pressure against living up even to the present old age benefit commitments we are passing on to the future. My guess is that in a contest for the use of tax revenues the children would win out. The old people may not be able to hold their own—especially if benefits should be increased further.

These considerations bolster Mr. Peterson's contention that our Social Security is not insurance in the sense generally accepted. It would be helpful if the word *social* were used with insurance, thus differentiating Social Security and its nonguaranteed benefits from life insurance and its firm commitments.

It would have been helpful if the Advisory Council which reported at the first of this year had discussed some of the problems that will emerge in the future under our present social security program. As it is, the report does have the effect of making people feel that everything is all right and that the program will go along smoothly as now laid out. I doubt that such a conclusion is justified. The next Advisory Council to be appointed in advance of the 1963 payroll tax increase should delve into these social security problems and make the public more aware of what lies ahead. Mr. Peterson's paper will be helpful to them in so doing.

(AUTHOR'S REVIEW OF DISCUSSION)

RAY M. PETERSON:

The response to my paper, as evidenced by the twelve written discussions and also by many oral nonrecorded observations, is very gratifying.

I hope that those reading the paper and its discussion will have previously read the Report of the Advisory Committee on Social Security

Financing and also the review of that Report which appears in *TSA* XI, 286–93. There is a continuity and interdependence among these items which the reader may find helpful.

Mr. Attwood's recommendations as to individual and collective activities of actuaries constitute a statesmanlike utterance. I am pleased that my paper has given him an opportunity to present these important and stimulating views to the actuarial fraternity.

I am interested in Mr. Attwood's reference to the impression of persons not occupationally engaged in work connected with pensions and insurance that the value of my paper is diminished by references to the threat of social security to private pensions and insurance. Actuaries working in the private area of providing economic security do have special interests, but anyone's interest can be that of a special interest or, from his point of view, a concern as to the public interest. I should like to feel that the specialized knowledge of actuaries would earn them the respect of the public generally and that this could be nourished by an increased capacity to communicate. What segment of our society may not be considered to have special interests, whether it be employers as represented by the U.S. Chamber of Commerce and the National Association of Manufacturers, labor as represented by the AFL-CIO, social workers as represented by the American Public Welfare Association, or the medical profession as represented by the American Medical Association?

In the paper, an attempt was made to focus attention on the probable burden that this generation is placing upon future generations by uninformed legislative enactments at this time. Is it in the public interest for this generation to put a greater burden upon future generations than we are willing to carry ourselves? To ask this question and to urge that an informed answer be sought and obtained can hardly be considered to be suspect as coming from any particular special interest. Rather, it reflects genuine concern with the public interest.

I believe that an able and informed witness appearing before congressional committees, regardless of his associations, will be listened to with respect. Although consulting actuaries predominated in the discussion of my paper, I find no record of any such actuaries appearing at social security hearings. Although there may not be a surplus of persons in the actuarial profession who would be both knowledgeable and effective witnesses at a congressional hearing, I am sure that there are competent witnesses from both the insurance company and consulting areas of activity. They should take advantage of opportunities to appear as individuals.

As to Mr. Calvert's gracious and complimentary remarks, I can only express my sincere gratitude. They are particularly meaningful to me, coming, as they do, from a member of our profession who is working extensively and imaginatively in the private pension field. Perhaps he may feel the call to appear as a witness at the next hearing on social security problems.

Mr. Calvert has effectively shown the Janus-faced posture of the Social Security Administration which, to speak bluntly, borders on duplicity. The Brief from which Mr. Calvert quotes, his Second Voice, is the Government's argument for a case before the October Term, 1959, of the Supreme Court of the United States, involving the termination of social security benefits pursuant to existing law with respect to a deported alien—one Ephram Nestor. Further excerpts from this Brief support the following notable points:

1. *Beneficiaries have no legal interest in the Trust Funds.*
   "The Trust Fund is, therefore, more in the nature of a contingency fund, and serves to facilitate the fiscal policies of Congress. The beneficiary or prospective beneficiary of the OASI program acquires no interest in the fund itself" [p. 11].
2. *Social security rights are established solely by having a wage-record in covered employment—not by the payment of taxes.*
   "Eligibility for OASI benefits is based upon someone's earnings record, not, as is often assumed, upon payment of taxes" [p. 9].
3. *Social security is a welfare instrument designed to deal with the social problem of the lack of basic economic security of large segments of society. Section 1104, which reads "The right to alter, amend, or repeal any provision of this Act is hereby reserved to the Congress", makes clear that rights are statutory, not contractual, and that Congress has the power to change the program in the future to reflect the then public policy and attitude as to the extent to which it is proper and necessary to use this welfare instrument.*

   "In summary, social security must be viewed as a welfare instrument to which legal concepts of 'insurance,' 'property,' 'vested rights,' 'annuities,' etc., can be applied only at the risk of a serious distortion of language. We are dealing with a social instrument by which public action, involving compulsion, is invoked to deal with a social problem—the lack of basic economic security of large segments of our society. An understanding of the difficult and changing problems of public policy arising out of attempts to eliminate individual or family insecurity on a national scale will be obscured by Procrustean efforts to force the social security program into the mold of inappropriate analogies . . ." [p. 68].

   ". . . One recent writer on the question of vested rights in OASI benefits has properly stated:

   '. . . A system of contractual social insurance involves the arrogant assumption that ours is the wisest generation of Americans for some time to come. If we have the legal power to tell generations yet unborn how the national income shall be distributed in some indefinite future, we shall have to be very clever in the way we assert that prerogative.

. . . .

'A statutory program of benefits can pay out higher benefits and can risk larger responsibilities. If a statutory program offers more now than the economy can afford to furnish later, or if established policies develop adverse side effects, then Congress has only to revise the statutory program. If Congress ever commits itself irrevocably to a general social-insurance program, the program will have to be a modest one.' [Wollenberg, *Vested Rights in Social-Security Benefits*, 37 Ore. L. Rev. 299, 359]" [p. 69].

Shades of Jeremy Bentham!

In a few effective words, Mr. Clare has put his finger upon the fundamental question to which we need the answer in social security planning —a question which has never been faced squarely in all the deliberations, debates and discussions of our social security system. He recommends that study be given to what we truly can afford as social security benefits and makes clear that the key to costs is the retirement age. Unfortunately, because of great pressure to relax and even eliminate the retirement test, the trend seems to be toward a lower average retirement age. To date, the average retirement age has been around 68 to 69.

The popular belief that the social security system is one under which benefits have been bought and paid for—the private insurance parallel—has encouraged the idea that the worker should become entitled to benefits at 65, whether working or not. (See Senator Keating's concept in the paper and Senator Douglas's idea as mentioned in Mr. Immerwahr's discussion.) This concept is found in editorials of responsible newspapers and in the columns of financial writers who should know better. For example, in the New York *World-Telegram and Sun* of November 4, 1959, we find these words in a special editorial entitled "Social Security Injustice":

The motive for the limitation on wages is to stop the elderly from working, on the questionable theory this would open more jobs for younger men. But many men and women of Social Security age still are vigorous and healthy. After they have retired from their regular jobs they would prefer to continue part-time employment which would keep up their interest in life and supplement the bare subsistence income they get from Social Security.

It is unjust to force them into unwelcome idleness on pain of losing *the insurance income bought with deductions from their pay checks and the contributions of their employers*. [Emphasis added.]

Rep. Willard S. Curtin (R., Pa.) is author of a bill which would raise the earnings ceiling to $2,400 a year or $200 a month. Eventually the limitation should be entirely removed. The $2,400 figure is, in our opinion, a minimum step to this and Mr. Curtin's bill should be passed.

In a nationally syndicated column of July 10, 1959, Sylvia Porter, the financial writer, has this to say about the "retirement test" in a column entitled "J. S. Forfeits His Social Security":

> J. S. will be 65 in August. For almost a quarter-century he has been paying the maximum social security tax on his earnings, and next month presumably he will be eligible to start collecting benefits.
>
> J. S. will not collect a penny, though. For he has a job from which he is earning and will continue to earn more than $2,080 a year, more than $100 a month—and because of the level of these earnings, he must forfeit his social security pension.
>
> "I don't want to retire because I'm 65, and my company isn't forcing me to," he remarked when I met him in the supermarket the other day. "Anyway, I haven't saved enough so that I can add to my social security pension and live on anywhere near the standard I need. I sure would like to get my benefits, but I guess I'm just out of luck."
>
> . . . .
>
> *Consider the fact that these armies of elderly people have paid taxes over the years to obtain these benefits at 65. They're not asking for charity. They've earned their pension.* [Emphasis Miss Porter's.]

You cannot forfeit something to which you have not become entitled!

If responsible, intelligent people have such understanding of our *social* insurance system, what can we expect the "man in the street" to believe? Can we blame Joe Doakes for putting heat on his congressional representatives? When people who should be informed are so oblivious to cost considerations, who *is* going to be concerned about the burden on future generations? Actuaries know that a shift in the average retirement age to 65 will increase old-age benefit costs 15% to 20%. Is anyone effectively telling the public this truth?

The broad study recommended in the paper and endorsed by Mr. Clare, among others, should provide an effective means to educate the public. We should truly make Herculean efforts to determine what we can "afford" by way of national compulsory pensions.

Mr. Feay has made a number of thoughtful observations. As to social security financing, he suggests that

> . . . social security taxes should be only slightly in excess of the normal cost for the benefits for new entrants. The accrued liability for the existing participants in the system should be covered by interest bearing bonds issued by the Federal Government to the social security system. . . . The accrued liability will thus be recognized as a charge against the entire economy and not against future new participants in social security.

In the paper, concern was expressed about the *employee* contribution rate exceeding the normal cost for new entrants. Mr. Feay presumably is referring to a limitation on the *combined* employee-employer contribution rate and on that of the self-employed. The original Beveridge Report recommended that the joint contribution rate for employees and employer should be limited to $\frac{5}{6}$ of the entry age cost for age 16 and that the Government subsidize the system to the extent of $\frac{1}{6}$ of this entry age cost and the interest on the accrued liability. This kind of principle prevailed in Great Britain until the recent major change in its national pension system involving an acknowledged abandonment of this principle.

If Mr. Feay's suggestion were made effective, one can gain some idea of how it would operate from these figures:

	Social Security Act of			
	1952	1954	1956	1958
Approximate unfunded liability at 3% interest (intermediate costs—in billions)	\$170	\$240	\$320	\$360
Approximate entry age normal cost (at 3% interest)	4.0%	4.6%	4.9%	5.25%

Under the present law, the combined employee-employer contribution rate rises from 6% in 1960 to 9% in 1969, and that for the self-employed from 4.5% to 6.75%. By Mr. Feay's suggestion, and in accordance with the British principle, the joint contribution rate would not be permitted to rise above 5.25%. There would be a Government subsidy for a significant part of the entry age normal cost and also for interest on the accrued liability at 3% interest of over \$10 billion. The "level-premium" payroll percentage under the present law is given as about 8.75%. The difference between this and the normal cost of 5.25% is 3.50%. This "level-premium" calculation contemplates the payment of interest on the unfunded liability based on an increasing annual payroll base which rises from a current level of around \$200 billion to \$450 or \$500 billion in the distant future. The equivalent level payroll base would appear to be in the neighborhood of \$300 billion; *i.e.*, 3% of an unfunded liability of \$350 billion would correspond to 3.50% of \$300 billion.

The *least* that should be done, as recommended in the paper, is to publish widely the entry age normal cost and also the amount of unfunded liability as it develops from time to time. This would consist of presenting a rational breakdown of "level-premium" cost figures which are now being used to serve the cause of "cost-consciousness." Congress has been told that the "level-premium" cost of the present benefits is about 8.75% of payrolls. This is usually described as "that constant combined employer-employee tax rate which would exactly pay for all future benefits." In no *official publication* of the Social Security Administration nor in testimony before and reports to congressional committees have I seen this "level-premium" cost presented as the sum of (i) normal cost for new entrants, plus (ii) interest on Y billions of unfunded liability, the latter being $y\%$ of an assumed increasing annual payroll base or $z\%$ of an equivalent constant annual payroll base of Z billions. Such a presentation would make clear the average cost for new entrants and the extent of the unfunded liability that was being passed on to future generations. (Incidentally, this is the "kind of frozen initial liability method accompanied by level-premium financing" mentioned by Mr. Niessen as referred to in the paper.)

In the case of an employer with a private pension plan, he might well be concerned about the payment of a higher joint contribution rate as to new entrants into his employment than would be required to provide the same benefits under a privately funded plan. The costs for such new entrants under a private plan should properly reflect the higher interest earnings that can be realized under a private plan.

Again, in applying the principle suggested by Mr. Feay, account would have to be taken of the dynamic nature of the social security system. We can expect continued pressure for liberalizing the benefit formula and raising the tax and benefit base as workers' average earnings rise. As indicated by experience, such changes will produce successively added segments of unfunded liabilities, higher entry age normal costs and consequent increases in the "level-premium." As the entry age normal cost rises, social security taxes on payrolls would presumably rise, and increased Government subsidies would be required to cover the interest on new segments of unfunded liability. If this feature of almost continuous increases through the years came to pass, the successive increase in social security taxes would mean that the taxes with respect to the entrants of any generation may well pay less than the value of their benefits. In applying this principle, appropriate consideration would have to be given to this increasing tendency and also to recognizing the necessity of not overcharging those whose benefits in relation to contributions are less than the average. Mr. Feay's observations do underline the questionable practice of expecting employees to pay one-half the cost of all future benefits.

As to my being resigned to the vagaries and uncertainties of the democratic process, I intended merely to be realistic about the way things are done by a representative government. No, I am passionately in favor of our elective system. I do believe that there is a large segment of our society who have the capacity to understand many public questions and to bring that understanding to bear on our elected representatives and to the so-called masses—but these capable segments of our society are not fully utilizing their capabilities in understanding public questions and, in turn, influencing both elected representatives and those who have not the same capacities to grasp fully large public issues. The social security system is an excellent example. Among the so-called educated segments of our society, there is appalling apathy, compromising complacence, and ignoble ignorance as to what the social security system is, what forces are working for its overexpansion, and what it may come to be unless they come to exercise the public responsibility which is theirs.

There *are* some political scientists who are greatly concerned about the effectiveness of our democratic processes in this time of major world problems. (See *Essays in the Public Philosophy* by Walter Lippmann, Boston, 1955, and "The American System in Crisis," by David B. Truman, in *Political Science Quarterly*, December, 1959.)

Unlike Lippmann's oversimplified social structure made up of "governors" and "the mass," Professor Truman of Columbia University states: "Those who occupy leading positions within the groups constituting the intervening structure of American society are, in the technical and neutral sense of the term, elites. Being more influential, they are privileged; and, being privileged, they have, with few exceptions, a special stake in the continuation of the political system on which their privileges rest." He states, in the conclusion to his article:

> Within that system, owing to peculiarities of the governmental scheme proper, the challenge to political maturity and sophistication is peculiarly the lot of those in positions of privilege in the structure of elites intervening between the government as such and the ordinary citizen. The capacity of that structure to respond appropriately is the crucial matter. We can demand and with considerable assurance expect vision and initiative from within the governmental sector. But we cannot confidently expect to see qualities of action governmentally unless they are supported from the ranks of the nongovernmental elites by a broad, consensual perception of the threats to the system that lie partially obscured in the responses to external events. Without that support the nation may survive, but the values embodied in its political system will be in constant jeopardy.

I consider actuaries among the nongovernmental elite. By definition, Professor Truman would also.

Our social security system should reflect our political maturity; it should not be shaped solely by the demands of those who are most vocal as to their needs, nor by those who are motivated *solely* by humanitarian considerations, nor by those whose most compelling motive is to get people to elect them to office. Rather, it should be shaped by those who have a highly responsible sense of what they may be doing to future generations by legislative actions taken at this time. We as actuaries must encourage and assist in the necessary intensive research which the governmental sector requires for sound legislative action.

As to governmentally operated pension systems in general, one can point to a few that are well-operated, as Mr. Feay does. He could also have included the program in the State of Wisconsin, where we even find variable annuities! There are many state and municipal pension programs, however, that are far from what they should be—such as that of Massachusetts—programs which are building up tremendous burdens for future taxpayers by the yielding of uninformed politicians to pressures of the day. If space permitted, I could even mention some cracks in the New York State retirement system.

Mr. Feay does well to issue a warning about the dangers of the use of improper actuarial assumptions and methods in the private pension field. One of the sorriest records of consulting actuaries during the pension wave of the last fifteen or twenty years is their failure to use up-to-date mortality tables for pension purposes. I believe they have ill-served their clients in using tables with little or frequently negative margins. Now, with rising interest rates, the Internal Revenue Service is concerned about overfunding and is pressing for the use of higher interest rates. Difficulty may be encountered in strengthening mortality bases to offset higher interest assumptions. How much wiser to have used mortality tables which they knew had some reasonable margin! My ideas on this have been on record for years.

Mr. Hanson, a younger member of the Society, ably places the social security financing problems in broad perspective. Indeed, it was the purpose of my paper to emphasize that the system could not be considered as operating in a vacuum. I would agree that the achievement of a stable currency for the next fifty years or so would go far to solve many of our fiscal problems, including the lesser one of social security financing. At the same time, each separate problem must be dealt with; we should not attempt to look at things so broadly that we lose sight of individual problems.

Incidentally, Mr. Hanson is in very good company when he stresses the overriding importance of stable prices. Lord Beveridge, in an interview reported in the December 7, 1959, issue of the *U.S. News & World Report*, said:

Inflation, to my mind, is one of the major evils that we have to get rid of. It makes social security very difficult, because the pensions which were sufficient when they were fixed by the state are not sufficient.

If the state has to raise the pensions, it has to take more from taxation. That means that, in fact, people are getting pensions which they haven't paid for on the social-insurance side.

It's a pity to have to do that. But remember this: Inflation causes difficulty for every other form of thrift, as much as for social insurance.

As to the President's veto of the Civil Service appropriation, it should be realized that no cash outlay was eliminated, there was merely failure to issue bonds to cover fully the required interest on the unfunded liability—bonds which would constitute an honest recognition of the growth of the national debt. Of course, the only way to avoid passing the burden on to future generations would be to exact sufficient taxes currently to keep the debt from increasing. It would seem very unwise, indeed, to increase social security claims on future productivity in reliance upon a future reduction in the armament burden. I enjoyed reading Mr. Hanson's stimulating comments.

Mr. Holcombe, another younger member of the Society, suggests (with an implied tribute to the responsible handling of pension funding by insurance companies) that the funding of the Civil Service Retirement System be turned over to the insurance industry. He recognizes that there would be formidable problems. I do believe that if this plan had been developed within the responsible environment of an insurance company or in the office of a consulting actuary who was very persuasive in selling his ideas, it would not contain a number of features which give the sensitive "actuarial soundness" nerves of the actuary a severe twinge. In Dorrance Bronson's book, *Concepts of Actuarial Soundness in Pension Plans*, pages 155–56, as he refers to a Civil Service Commission statement which called the program "a pattern for other public and private systems," he mentions a number of features of the Civil Service Retirement program which "violate traditional actuarial soundness, both on the grounds of inequity among employees and on the basis of injecting costs not susceptible of measurement." These features include (*a*) early retirement elections with benefits far higher than the actuarially equivalent normal benefit, thus muddying future costs since no one can measure the many bargains that will be chosen; (*b*) benefits which are greatly disproportionate to employee contributions—much to the disadvantage of the single male or female employee; (*c*) joint and survivorship options with no protection against adverse selection and with substantial bargains and inequities in the reduction factors; and (*d*) "a disability feature so liberal that a private plan would be mired by it." He adds: "These are examples of what political pressures can do with the benefit specifications of public pension plans and with the seemingly perpetual postponement of costs to be met, in the end, through increased appropriations by Congress from general taxation." (Mr. Feay, please note!)

The actuarial inequities and bargains referred to by Mr. Bronson are described in more detail in an article entitled "Civil-Service Retirement Program, 1959," by John P. Jones in the July, 1959, *Social Security Bulletin.*

I wonder if Mr. Holcombe now wants an insurance company to take over the Civil Service Retirement Plan.

I like Mr. Holcombe's suggested simple and clear statement explaining the real nature and function of a social insurance system.

Mr. Immerwahr also recommends a statement designed to contribute to public understanding. This serves to illuminate very effectively (and in more detail than that of Mr. Holcombe) the true nature of social security financing. With these two suggestions and by drawing on the content of the Brief, Flemming *v.* Nestor, I am challenged to expand my suggested descriptive statement and offer it for public enlightenment in an effective way.

Referring to Mr. Immerwahr's recorded experiences while on the staff of the Bureau of Old-Age and Survivors Insurance, I am pleased that he found an opportunity to make them public. Incidentally, I wish to emphasize that my use of the words "actuarial anesthesia" was not intended as a criticism of social security actuaries—rather, it was intended to describe the state of mind of many nonactuarial persons who, whether through ignorance or deliberate purpose, have misused and distorted the significance of the work of actuaries. As a further incidental comment, I would not say, as he does in his proposed statement, that employer social security contributions are "made on behalf of" an employee.

Mr. Linton, long recognized as an authority in the field of social insurance as well as many others, has skillfully brought the substance of my paper into focus, for which I am grateful. His discussion, while not intended to be a summary, will serve as an effective brief statement of the main points I sought to make and can be read by those who might find the paper too long. Mr. Linton emphasizes that there is a permanent burden being passed on to future generations and that, in the matter of passing on costs, the problem is not a transitional one.

There is a reflection of this view of a temporary transitional problem in these words from a letter Dr. Arthur Larson wrote to me:

The passage [following the summary on page 827 of the paper] disturbs me a bit, because it does not seem to take into account the reason why I consider the disproportionate favoring of older entrants into the system to be relatively unimportant. The reason is that the discrimination is a temporary one which will disappear when the system reaches maturity. My idea was to characterize the system as it would be in its mature state, and to take the emphasis off discriminations which are an unavoidable part of the transition period from no social security at all to a mature system.

Dr. Larson is correct in observing that among future generations that contribute during their entire working career, there will be no discrimination as to the duration of contribution. It is, however, this very initial discrimination between the present generation and future generations as to the relative amounts contributed to the social security system that creates a financing system that is permanently different from private insurance.

In giving permission to use the above quotation, Dr. Larson also suggested that his ideas are most accurately reflected by this quotation from his book:

Most of the arguments you hear about social security stem from a disagreement about the basic nature and purpose of the system.

One idea is that it is essentially a social benefit provided by a beneficent government.

The other is that it is analogous to privately purchased insurance policies and annuities.

To understand our unique system, one must constantly remember that it is based on both philosophies, and attempts to give effect to both the private insurance and social benefit theories.

This would appear to be the Larson Blend.

As to the principle of limiting joint employee-employer payroll taxes so as not to exceed the value of benefits to be received for a new entrant, the Beveridge Report advanced such principle as a matter of *equity* in these words:

For the purpose of this analysis the view adopted on similar occasions in the past has been followed, namely that for assessing the rate of contribution which can equitably be charged in a compulsory scheme of Social Insurance a fair basis is obtained by expressing the value of future benefits to a new entrant at the minimum age of 16 in terms of the contribution, payable throughout working lifetime, which should be made to insure the benefits on an actuarial basis; this is commonly termed the actuarial contribution.[1]

[1] Sir William Beveridge, *Social Insurance and Allied Services* (American ed., reproduced photographically from the English edition; New York: Macmillan Co., 1942) p. 177.

The test was not one of being able to buy equivalent benefits from a private insurance company. As mentioned in my comments on Mr. Feay's discussion, however, an employer might well make comparisons with his ability to provide equivalent benefits for new employees under a private pension plan. This principle of relating payroll taxes to costs for a new entrant was also intended in Great Britain to serve as a discipline in keeping social insurance benefits within proper bounds. If benefits were increased, payroll taxes would be increased based upon the increase in costs for a new entrant. Great Britain found that this was an inadequate discipline and it has been abandoned. As is evident from recent discussions by British actuaries of their Government's White Paper entitled "Provision for Old Age—The Future Development of the National Insurance Scheme," as reported in Vol. 85, Part I, No. 369 of the *Journal of the Institute of Actuaries*, they are greatly concerned about this matter of discipline. There appears to be a consensus in favor of a principle expressed as follows:

> Mr. C. M. O'Brien, in opening the discussion, said . . . it was in forty or fifty years' time that the day of reckoning would come. It was therefore vital that there should be some discipline within which political and social arguments could range, and which would contain those arguments within prudent financial bounds. The more he looked at the problem, the more he believed that the detail, indeed perhaps more than the detail, was a matter for political and social argument, but that they as actuaries had to determine certain basic restraints, and persuade politicians to accept them.
>
> Having said that, he could hardly avoid giving his opinion of what those restraints should be. He thought there was only one. They should not commit future generations to pay proportionately more to provide their pensions than they themselves were prepared to pay for the preceding generation's pensions. It was a flexible principle in that the interpretation of "not paying more" could accommodate all reasonable political and social viewpoints. That flexibility and indeed the obvious universality of the principle had a particular value. If their views flowed from a principle so manifestly reasonable and practical there was the more chance that they would be heeded.

The only discipline of cost and benefit control which we have used in this country has been the calculation of "level-premium" costs, but with the cost impact deferred by the use of an upward graded contribution schedule considered the approximate equivalent of the "level-premium" costs.

Perhaps some of the semantic façade involving the conception of social security taxes as premiums arose from the use of this technical actuarial expression derived from conventional insurance pension funding principle and practices. I believe the use of this concept has contributed as much to *discounting* an appreciation of future cost burdens as it has contributed to *adequate* appreciation and understanding. Since such "level-premium" figures are made up of the sum of (i) entry age normal cost and (ii) interest on unfunded liabilities, an appreciation of future burdens would be better achieved if so displayed. Our experience to date has not demonstrated that this "level-premium" cost approach has been effective as a discipline. Whatever cost impact it has is watered down by graded future contribution rates. Benefits have been repeatedly liberalized, and there are current pressures for greatly increased benefits.

As Mr. Linton warns and also Dr. Robert M. Clark in his Canadian study, the occasion of successive increases in tax rates will likely bring pressures for increased benefits—not only as a normal human reaction, but also because of the unfortunate depiction of the social security program as greatly similar to private insurance—"if I pay more, I should get more." Unless benefits are increased along with taxes in 1960, 1963, 1966, and 1969, there is a distinct possibility of a "din of inequity" arising on each of these occasions.

I do believe that in order to justify the taxing of an initial bracket of earnings for social security purposes, it is vital as a matter of equity and fairness that the value of employee contributions not exceed the value of benefits to be received. This principle obviously cannot be followed precisely. In order to keep within reasonable range of the many varying circumstances, the principle could be reasonably implemented by limiting the employee payroll tax to, say, 80% of the cost for the average new entrant into the system. To illustrate, the normal cost under the 1958 Act appears to be 5.25%, and an 80% limitation would be 4.2% of earnings, as contrasted with the 4.5% tax rate for 1969. If benefits are liberalized, this limit would rise with increase in normal entry age costs. Such a limitation would put a greater burden on the employer. I believe that possibility must be entertained unless we are willing to accept the idea of some direct subsidy from general revenues.

Under the new Swedish program, employers are scheduled to pay the entire costs. Would it be entirely unreasonable to expect that the sharing of costs between employee and employer under both the social security system and the railroad retirement system gradually shift from a fifty-fifty basis to, say, a forty-sixty basis? One original form of the railroad retirement system did contemplate a $\frac{1}{3}$–$\frac{2}{3}$ division of costs between employees and employers.

In all of these considerations of who pays the cost of what, we cannot and must not get away from the fundamental question of what is the real burden upon future productivity; what can be afforded from future production, as Professor Clare asks and as Mr. Linton emphasizes. We must not become anesthetized by the semantic façade of contribution and benefit formulas, "level-premium" cost estimates, and the entire panoply of an extremely complicated law and thus lose sight of the fundamental question.

As would be expected from him, Mr. Myers' discussion is a valuable adjunct to the paper.

He chides me a bit for pointing out many dilemmas without offering solutions. It would have been presumptuous of me to offer precise solutions in a dogmatic, omniscient manner with regard to such a massive social, political and economic problem. I did suggest, as a major conclusion, that there should be established an Advisory Council with much broader authority than the present law contemplates to tackle questions that have never been treated adequately. Messrs. Calvert, Clare and Linton agree with me in this recommendation. I believe it to be important that such a Council should have no member who would find himself in the possible position of defending opinions and recommendations with which he had been associated in the past. I am sure there is enough talent in this nation to comprise an Advisory Council of new blood and new faces.

I have seen no evidence that the Social Security Administration has made any real efforts in its publicity to distinguish carefully between private insurance and social insurance—indeed, as shown in the paper, and as Mr. Immerwahr has observed, the evidence is quite to the contrary. As to the statement quoted from "Your Social Security," my objection is the subtle, semantic suggestion that social security contributions are *saved* for the employee in the trust fund and that *such* contributions are then paid out to him as benefits. This booklet would be made a more honest document if it included some of the statements from the Flemming *v.* Nestor Brief, and also statements recommended by Messrs. Immerwahr and Holcombe.

Mr. Myers intimates that in the paper *I* considered employer contributions allocable to individual employees. I had no such intention; indeed, my proposed statement descriptive of the system is quite to the contrary. My point was that the parallel frequently drawn with private insurance will have the effect of establishing in the public mind the idea that employer contributions are made "on behalf of the employee." For example, note the following statement by no less a person than the Chairman of the Ways and Means Committee, Wilbur D. Mills, which appeared in *Nation's Business*, November, 1959, on page 76:

> Do you work for a salary? If so, your employer makes a contribution on your behalf to the Old Age and Survivors' Insurance Trust Fund maintained by the federal government to provide you an annuity upon your retirement. You needn't include that contribution in your income; nor do you include the annuity in your income when eventually you receive it.

Just who is allocating employer contributions directly to employees?

I would agree that the payroll deduction system dulls the employee's consciousness of his social security taxes as such. He must be aware, however, of a reduction in take-home pay and this probably results in increased wage demands over what they would otherwise be. Employees should be effectively told, particularly young entrants to the labor force, of the approximate relation between the value of contributions and value of benefits. This is a moral thing to do and is in harmony with the spirit of the Federal Disclosure Law. Also, more effective measures should be taken to make clear to the self-employed that one-third of their social security tax is considered to be made by them as employers and not employees, even though under the law it is an income tax and not an excise tax.

As intimated above, the solution to the problem of coming difficulties with the fifty-fifty contribution principle would be gradually to shift to a larger proportion for the employer so that employee contribution rates (and $\frac{3}{2}$ of that for the self-employed) would not exceed, say, 80% of the cost for new entrants. Then, as Mr. Linton outlined, the employer is serving the function of a "full reserve" by paying, as a level percentage of rising payrolls, interest on the unfunded liability. This is a more rational principle than the present "fifty-fifty self-supporting" principle.

Mr. Myers is rather naïve in minimizing the effect on the public of increases in social security taxes. As to public reaction, see the December 21, 1959, issue of *U.S. News & World Report*, page 93. In an article entitled: "It Keeps Costing More For Your Old-Age Security," the opening sentence reads:

> The tax for Social Security, going up now, is getting as high as the income tax for many workers. Time may not be far off when the Social Security tax will be \$1 for every \$9 or \$10 in a worker's pay check—and no deductions.

Under these circumstances, the pressure for increased benefits can be overwhelming. Also, there are many vigorous proponents today advocating generous enlargements of the system. These include Wilbur Cohen, the AFL-CIO, Senator McNamara, Governor Meyner of New Jersey, and the Democratic Advisory Council.

Mr. Myers and Mr. Niessen criticize my analysis of the railroad retirement and social security financing methods as drawing too much "from the point of view of traditional pension funding theory." May I make clear that I was in no way attempting to measure the financing of the social security system by the same standard or philosophy which applies to private voluntary plans. In developing some major points as to the social security system, however, I used actuarial tools which happened to originate in traditional pension funding—tools and concepts which Mr. Myers and Mr. Niessen use quite generally in their work and reports; *e.g.*, "level-premium costs" and "normal costs." With these actuarial tools, I sought to make these points.

a) People should truly understand the cost of social insurance programs; *i.e.*, the nature of the financing method and the incidence of costs as among individuals and generations; and

b) There is a practical and equitable limit to the level of employee contributions as a percentage of an initial bracket of gross income—a limit which is in danger of being exceeded under the present method of financing social security.

I regret that neither Mr. Myers nor Mr. Niessen saw fit to address himself in any searching way to the question as to the continued successful operation of the "fifty-fifty self-supporting" principle. There *was* a suggestion by them that you can get away with more inequity under a compulsory system than under a voluntary one.

A vital clue as to whether an employee "fifty-fifty" contribution rate is creeping up on the entry age normal cost is a comparison of the rate of growth of the normal cost with the rate of growth of that part of the "level-premium" cost which represents interest on unfunded liabilities. Using the figures in columns (1) and (2) of the table appearing in Mr. Niessen's discussion, the normal cost for the railroad retirement plan increased from 5.20% in 1944 to 9.60% in 1959, or about 85%. In contrast, the percentage contribution to cover the interest on unfunded liabilities increased from 3.79% in 1944 to 8.21% in 1959, or about 117%.

Turning to social security figures, the estimated[2] level premium cost under the 1952 Act, at 3% interest, is about 6.0% and the normal cost is about 4.0%. The corresponding figures under the 1958 Act are about

[2] Letter from Robert J. Myers.

8.75% and 5.25%. Thus, the normal cost increased 31%, and the contribution rate reflecting interest on unfunded liabilities increased from 2.0% to 3.5%, or 75%.

In both cases we see evidence of the more rapid growth of unfunded liabilities than the rate of increase in the normal cost. These figures reflect a significant and fundamental symptom of growth of a "fifty-fifty self-supporting" financing method. It is *this* symptom which I wish Messrs. Myers and Niessen had commented on.

There are several statements in Mr. Niessen's discussion to which I feel I should reply.

I did not, as Mr. Niessen infers, attempt to set down a statement designed to present an accurate image of the railroad retirement financing method. It is an interesting project—and much needed. As suggested earlier, I believe that the day is not far distant when railroad employers will need to pay more than one-half of railroad retirement costs. The railroads have not in the past paid nearly as much for retirement plan costs as have employers in other industries. The confining effect of the "fifty-fifty self-supporting" principle has prevented the railroads from doing a job on past service funding such as has been done in the last fifteen or twenty years by many private industries. A comparison of "funding ratios" as developed by Bronson[3] will demonstrate this fact. The 1959 Amendments to the Railroad Retirement Act pushed costs further into the future by introducing a rising graded contribution pattern. These future costs will make it even more difficult for the railroad to compete with other forms of transportation. Although the Railroad Retirement Act was hailed at its initial enactment as a great step forward in joint labor and management action, this observer is convinced that it has proved to be unwise legislation. If railway workers had been brought under the social security system and the railroads had funded private plans supplementing social security benefits, as other industries, the program would have had a real opportunity to become better funded by transportation users of the past paying for their proper share of retirement plan costs. The great growth of private plans and their funding in recent years does not support this statement of Mr. Niessen's: "one might say that the compulsory membership in the . . . railroad retirement system is worth a great deal to the employees since otherwise they would have in all likelihood been left without worthwhile retirement protection."

[3] *Concepts of Actuarial Soundness in Pension Plans,* Tables 3 and 9.

Mr. Niessen criticizes my relating actual contribution tax rates to normal costs. I shall use Mr. Niessen's own words in reply.

It is important that new entrants not be required to pay more than a specified percentage (under 100) of the cost of their benefits. There is no argument about that. But the treatment accorded new entrants can be analyzed simply on the basis of the calculated normal cost and the actual contributions; no unfunded accrued liability figure is needed for this purpose.[4]

The employee contribution rate scheduled for 1969 is $93\frac{3}{4}\%$ of the estimated normal cost under the 1959 Amendments. I should think by Mr. Niessen's criterion quoted above, things are getting rather warm!

Mr. Niessen's comparison with private insurance costs in columns (3) and (4) of his tabular exhibit is unsatisfactory by reason of, at least, these considerations:

a) Presumably the deferred life annuity used provided cash values; *i.e.*, no benefit from withdrawals is involved, whereas withdrawal rates are used in computing railroad retirement costs;

b) If benefits are deferred under the individual contract until the average retirement age under the railroad retirement system, which may be 67 or 68, larger benefits will be realized;

c) The mortality assumptions for the deferred annuity contract probably allow for greater improvement in mortality than do the valuation assumptions of the railroad retirement system, which can be revised. The Actuarial Advisory Committee had this to say about mortality assumptions used in the December 31, 1956 Valuation: "The assumptions are believed to be reasonable, although they may understate rather than overstate the actual costs."

d) A higher rate of investment earnings will likely be realized by an insurance company than by the Railroad Retirement Fund.

As to the phrase "kind of frozen initial liability method accompanied by level-premium financing," Mr. Niessen makes the explanation that would be expected by those familiar with the matter, but that does not correct the impression of the lay reader of the *Social Security Bulletin*. Does Mr. Niessen offer the same explanation for the social security system to which he also applied the phrase? This imprecise and almost meaningless phrase demonstrates the lingering need to rely upon traditional pension funding theory and concepts (for which Mr. Niessen criticizes me)

[4] Abraham M. Niessen, "Measure of Actuarial Soundness in a Pension Plan of the Railroad Retirement Type" (Author's Review of Discussion), *TSA* VI (1954), 531.

and the paucity of accurate terminology to describe the amorphous miscegenation represented by the railroad retirement financing method.

Mr. Niessen also criticizes me for using *gross* unfunded liability figures. I shall reply to this criticism in his own words:

It is, of course, true that the calculated over-all costs for railroad retirement will remain the same regardless of how one views the effect of coordination with OASI on the unfunded liabilities.[5]

Although I am sure that the staff of the Railroad Retirement Board has done an excellent job in trying to convey to labor, management and members of Congress the many intricate and complex features of railroad retirement financing, I am far from convinced, after reading many pages of testimony at congressional hearings, that they have achieved any large measure of success. For example, in the January 1960 issue of *Fortune,* Perry M. Shoemaker, president of the Delaware, Lackawanna & Western, complains about railroad retirement plan legislation in these words:

Another great blow to the railroad industry was the passing by Congress, and the signing by the President in 1959, of legislation increasing the costs of railroad retirement and unemployment insurance. This action was inflationary and discriminatory, and contrary to the expressed policy of the Administration. The trucking industry and business generally are under the Social Security Act. If the Lackawanna Railroad, in 1958, had been under Social Security, its retirement-tax cost would have been about $750,000 instead of the $2,100,000 actually laid out by the company. . . . The 1959 legislation means that the Lackawanna's 1960 payment will be about $3,700,000 and by 1965 it will be $4,400,000. This change represents politics at its worst. The result is another body blow to the railroads' economic ability to survive, the nationwide annual cost being $440 million by 1965. Railroad employees are fine workmen and should not be discriminated against, but there is questionable justification for giving any group a favored position by statute as compared with other American working men. [P. 168.]

This statement evidences lack of knowledge of the retirement plan costs other private business is incurring for supplemental private programs and also lack of appreciation of the retirement plan costs that must be met in the future because of the inadequate funding done in the past —such inadequacy arising from the frozen "fifty-fifty self-supporting" pattern and political delay.

As a final comment on Mr. Niessen's discussion, the gross unfairness of requiring "employee representatives" to pay the full 18% tax for

[5] *Ibid.*, p. 26.

benefits worth 9.6% should be a matter of concern, whether there be involved 10, 100, or 10,000 persons.

In discussing the Civil Service Retirement and Disability Fund, I referred to the Treasury Department regulations applying to private retirement plans. Mr. Niessen has kindly furnished the following clarifying statement by Mr. Walter Wilcox, an actuary associated with the Internal Revenue Service:

> A pension plan and trust would not be disqualified merely because that liability [initial unfunded] had been permitted to increase. Certain restrictions on payment of benefits are generally imposed under those circumstances in nongovernmental plans in order to limit the possibility of discrimination in favor of officers, highly compensated employees, stockholders, and supervisory employees. (Such discrimination would result in disqualification at any time regardless of the condition of the unfunded liability.) Discrimination of this nature could not occur in a governmental plan and for that reason the usual restrictions are not applicable.

Discrimination as to sharing cost burdens certainly can and does exist between generations of taxpayers with respect to governmental plans—a far more serious form of discrimination!

Mr. Siegel has underlined the import of the momentum of the social security system by showing the rapid growth of the disability feature. Current active proposals for its further expansion furnish additional evidence of this momentum. The "entering wedge" technique is now a device whose use is frankly admitted by the proponents of large social security. This means that the only proper way to appraise the cost and significance of any new or enlarged programs is to examine in the most searching way the ultimate form of such proposals—not merely some guesses as to so-called "level-premium" costs, but their ultimate burden upon future generations and their social and economic impact upon all the institutions of our national life which we hold in high regard. Otherwise, we will be giving ourselves another injection of an actuarial anesthetic.

Our social security Jeremiah (to use Mr. Pedoe's apt title for Mr. Williamson) comments pungently on the "jerry-built structure" of OASI. (I am sure there is no relationship between our "Jeremiah" and "jerry-built.") I wish to thank Mr. Williamson for filling in some of the gaps associated with my "understatements" which can be accounted for either by my incomplete information or by my belief that extreme statements can be ineffective. As a part of the social security semantic façade, Mr.

Williamson has mentioned several types of misconceptions and missing perceptions. His points emphasize the importance of better understanding of the social insurance organism we have created and the compelling need of a language that is properly descriptive. I am impelled to quote again from the writings of Jeremy Bentham: "Error is never so difficult to be destroyed as when it has its root in Language."

May I say that I have no quarrel with the term "social insurance" as describing a program provided by society at large and under which there is a pooling of risks. As stated in the paper, however, the absence of the word "social" is a serious deficiency.

There is wide divergence of opinion as to what social insurance should cover in the United States. It is imperative that we get back to the constitutional authority for the system. The Preamble to the Social Security Act of 1935 reads: "To provide for the general welfare by establishing a system of Federal old-age benefits, etc." The government Brief for Flemming *v.* Nestor, as quoted above, explains that "social security must be viewed as a welfare instrument," and continues: "We are dealing with a social instrument by which public action, involving compulsion, is invoked to deal with a social problem—the lack of basic economic security of large segments of our society."

It would follow that where or when there is no lack of basic economic security of large segments of society, there is no constitutional justification under the general welfare clause for social benefits. Any new program or any enlarged program should be tested as to whether it does more than provide "basic economic security" and also as to whether "large segments of society" are involved.

Mr. Williamson's remarks suggest serious questions of public morality. Are the following consonant with public morality:

(i) To depict the social security system as greatly similar to private voluntary insurance?

(ii) To fail to explain to "the man in the street" that current taxes are largely required to pay current benefits?

(iii) To fail to make clear to "the man in the street" that social security benefits are not a contractual vested right?

(iv) To enact legislation involving greater commitments for future generations than the current one is willing to assume?

(v) To advocate generous expansion of social security benefits with a bland and blind confidence but with no confirmed assurance that an expected great growth of the national product will enable us to afford such benefits?

I submit that such actions and inactions all savor of public immorality.

Mr. Linton and Mr. Myers were the only persons to comment on the income tax treatment of social security contributions and benefits. Mr. Linton referred to the deduction of social security contributions from gross income as a means by which some of the cost would be borne by general taxpayers, but it was not clear to me that such practice has his endorsement. Mr. Myers approves of the inclusion of social security benefits in taxable income, but he makes no comment as to the treatment of contributions. The income tax treatment of all forms of retirement income and contributions therefor was the subject of a panel discussion before the Ways and Means Committee on December 7, 1959. The panel, comprised of four college professors, an independent practicing lawyer, a consulting actuary, a labor representative, and two persons from business management, advocated almost unanimously a statutory change to permit the current deduction of employee contributions to private and group plans, including social security, and the uniform taxation of all such benefits when received. As reported in the *Wall Street Journal* of December 8, "The panelists advocated uniform taxation by which persons would claim deductions on amounts contributed and be taxed on the benefits when received." This is in accord with the recommendations in my current paper and also those I made in an article entitled "The Payout Principle of Taxation For Retirement Income Programs Should be Applied Without Discrimination," in the Spring, 1959, issue of the *C.L.U. Journal*.

During the coming decade of the Sixties, are social security developments to come "like sixty" or will all proposals be soberly and exhaustively examined not only from the humanitarian point of view but within an appropriate broad frame of reference—a frame that will include adequate consideration of what we can truly "afford" and a thorough study of the social and economic impact of all proposals?

It is not sufficiently realized what really happens upon the enactment of increased social security benefits or added benefits, such as medical care.

(1) The present generation of voters, including the existing old age segment, decides to provide benefits for itself for which its members pay a small part of the cost, or none;
(2) Present nonvoters and future generations are having a decision made for them which declares that they must pay taxes during their entire working career in order that we may enjoy the benefits we have voted for ourselves;

(3) A momentous decision is made for such future voters, with the effect that they will have a greatly limited choice as to how they will provide for their own income and medical needs in old age, and that they are committed to contributions which will impair their capacity to save for these purposes.

In the statement of Walter Reuther at the Forand Bill Hearings in July, 1959, made on behalf of the AFL-CIO, the following words appear:

> We recognize that the new benefits will cost money, and *we stand ready to meet the cost.* Under the Forand Bill, social security taxes would be increased by a quarter of 1 percent of taxable payrolls, both for employees and employers. [Emphasis added.]

Does this willingness to pay (presumably by social insurance financing principles) apply only to the stated tax rate or to a probable cost double or triple such rate? If this willingness to pay is interpreted in the private insurance sense, the cost for current workers would be many times greater and truly *infinitely* greater for current beneficiaries. Can Mr. Reuther speak for the young of this generation and the members of future generations?

I wish to close this reply to discussion by emphasizing a major problem which should have the consideration of a new Advisory Council with broad responsibilities as recommended in the paper. As the fundamental question, Professor Clare urges consideration of what social security benefits we can "afford." The question is really two-pronged: How much old age income can we *afford to provide* through a nonreserve social insurance system? How much can we *afford to fail to provide* through funded private programs of employers and individuals?

In his recent book,[6] Emmet John Hughes identifies three major forces in a coming "revolution in economic wants." They are (1) the explosion of population, (2) "the constant conflict between the demand for consumer goods and the need for capital investment," and (3) "a friction [that] . . . rises from the contrast—the everwidening contrast—between nations rich and nations poor." Speaking of the second force, he says: "Political courage in a government, and foresight and forbearance in a people, are abundantly required to make possible a prudent choice—and choice must be made—between more food today and more factories tomorrow. Yet few of the most needful and anxious nations are gifted with any such political faculties." Here he has put his finger upon the crucial question of spending versus saving. Compulsory social security legisla-

[6] *America the Vincible*, pp. 28–29.

tion that freezes for decades a pattern which encourages spending rather than savings could have disastrous effects.

In their statement to the Ways and Means Committee relating to the income tax treatment of retirement programs, Mr. Frank B. Cliffe and Mr. Allen D. Marshall had this to say of the importance of savings:

> We subscribe to the view that each person should exercise thrift, put something aside for the "rainy day" and for retirement—including the larger medical care costs often experienced in old age.
>
> In the aggregate, we believe this is of particular national importance today and in the years to come. In addition to the current needs for capital funds for business expansion and for new homes, we are now in the midst of a rising wave of demand for new money savings. This wave is now in the sector of public capital and will, in the near future, move into the private sector.
>
> An outstanding example is that for new, and more, educational facilities—for elementary schools. This wave of demand is even now moving on to the area of secondary schools and college facilities.
>
> Within a few years, this phenomenon will be manifested as greatly expanded capital requirements by private enterprises. During the next two decades—by 1980—we will see roughly twice as many young people have entered the labor force seeking jobs, as workers now 45 to 64 will have reached the age of retirement from the labor force. New young families will be formed on an unprecedented scale—and they, naturally, will be wanting homes. We are today in the first stage of a prodigious rise in new capital requirements—public and, especially, private.

The economist, Robert L. Heilbroner, author of *The Worldly Philosophers*, has recently emphasized this great need for new capital in these words:[7] ". . . if a rapid and continuing rise in our standard of living is to remain our main economic objective, we must have a high level of investment."

Will an overexpanded social security program seriously discourage these needed savings? I am greatly concerned that it will. Preliminary reports of studies being made by the National Bureau of Economic Research indicate that the funds accumulated under private retirement plans have constituted largely, and probably entirely, a net addition to savings. If this fact is fully or even partially confirmed, it constitutes a compelling argument for the encouragement of private funded programs and the limitation of social security benefits to a well-defined basic floor of protection.

[7]Robert L. Heilbroner, "The Future in America: I. The Price of Growth," *The Reporter*, January 7, 1960, p. 32.

As our general state of economic well-being improves, there really should be less need for social insurance benefits. Something in the nature of a self-liquidating feature might well be built into the system. The first step is to make the benefits includable in taxable income, and the second step is to halt the rise of benefits coincident with the rise in average earnings of active workers. This would provide greater margin for individual savings and would ease the great burden that future generations are scheduled to bear. It would also lessen the danger of having to exercise the Government's power, as provided by Section 1104, to reduce scheduled benefits at a future time under compelling economic circumstances.

Social security benefits create only statutory rights. The words quoted with approval in the Government's Brief for *Flemming* v. *Nestor* explains the reason for Section 1104:

> A system of contractual social insurance involves the arrogant assumption that ours is the wisest generation of Americans for some time to come. If we have the legal power to tell generations unborn how the national income shall be distributed in some indefinite future, we shall have to be very clever in the way we assert that prerogative.

In a speech to the American Public Welfare Association on December 3, 1959, Professor Wilbur Cohen expressed the following "arrogant assumption":

> I believe that during the next ten years the productivity of our nation will continue to grow due to automation, research, inventions, new processes, products and services. It will be possible, therefore, for our country to afford significant improvements in our Social Security system from these increased resources so that every aged, disabled person, and every widow and orphan will have sufficient income to enable him to live in health and decency.

Professor Cohen is the bell cow of that group that has made a sacred cow of the framework of the social security system on which layer after layer of tax and benefit may be stacked—a sacred cow, which, by a reversal of roles, can milk the capacity of future workers to save and to provide for themselves as they choose.

These proponents of greatly enlarged benefits accept the tenuous actuarial balance of Mr. Myers's "level-premium" calculations as a completely sufficient test of the soundness of the system. This actuarial anesthesia has become an intoxicant for them which, at once, makes them see a glowing picture of a social insurance paradise and blinds them as to how benefit costs will be truly met in the future and as to how savings will be encouraged to provide the capital for needed production. To me, with seven grandchildren, this is a frightening situation. In this paper of Professor Cohen's entitled "A Salute to Twenty-five Years of Social Security," he says, "We must never forget the important role in the evolution of social legislation played by responsible and dedicated men and women including politicians, social workers, social reformers, economists, lawyers and administrators." Note that actuaries were not mentioned—they provided only the misused anesthetic!

Is there a real challenge here for actuaries and others of the nongovernmental elite?