Financial Policy in Old-Age and Survivors Insurance, 1935–50

by JAMES S. PARKER *

The United States Senate, in a resolution adopted August 1950, authorized its Finance Committee to make a further study of social security.* [1] *The financing of old-age and survivors insurance is one of the subjects specifically named for examination. The financial provisions, which have been almost continuously under public discussion since 1935, thus remain one of the major areas for study.

SIGNIFICANT debates on the financing of old-age and survivors insurance preceded and accompanied the enactment of the original Social Security Act of 1935 and its revisions in 1939 and in 1950. Contribution rates, reserve fund accumulation, and current-cost versus level-premium financing were the topics most widely debated. The same issues were involved in the discussions that led Congress to freeze repeatedly the employer-employee contribution rates at 1 percent each from 1937 through 1949. A brief review of these discussions and of the legislative action taken during the first 15 years of the Social Security Act should be helpful in any consideration of future financial policies.

The 1935 Act

Two financial aspects of the 1935 legislation were of primary importance—the contribution schedule and the reserve basis. The contribution schedule in title VIII of the Social Security Act of 1935 fixed combined contribution rates for employers and employees at the following percentages of payroll: for 1937–39, 2 percent; 1940–42, 3 percent; 1943–45, 4 percent; 1946–48, 5 percent; and for 1949 and thereafter, 6 percent. The contributions were to be paid into the general fund of the United States Treasury.

Title II of the act created in the Treasury an old-age reserve account and authorized an annual appropriation to this account "sufficient as an annual premium to provide for the payments required under this title, such amount to be determined on a reserve basis in accordance with accepted actuarial principles." The funds in the account were to be invested in special obligations issued to the account or in other Federal obligations, but in either case at a minimum interest rate of 3 percent. In 1935 the Secretary of the Treasury, on the basis of program costs estimated by actuaries of the Committee on Economic Security, had told the House Ways and Means Committee—then holding hearings on the proposed Economic Security Act— that the reserve fund accumulated under the act would amount to approximately $50 billion by 1980.

The Committee on Economic Security in its final report had recommended alternative contribution schedules, both of which would ultimately have required inauguration of a Government contribution. The Committee later abandoned these recommendations in favor of the schedule that was finally enacted, largely because it eliminated the need for a Government subsidy.

Financial Developments, 1935–39

Between 1935 and 1939 the financial provisions were reviewed and the cost estimates prepared by the Treasury Department and by the Social Security Board were revised. During this period, also, there was much public discussion of the reserve principle embodied in the 1935 act, and some strong opposition arose.

The Treasury's 1937 valuation balance sheet showed the assets and liabilities of the trust fund and was accompanied by an estimate "that the fund will reach $50 billion in about 45 years and after some 35 more years it will become stable at about $57 billion."

Although these 1937 estimates were in actuarial balance, the Treasury's 1938 valuation sheet showed a deficiency of about 12 percent in expected income as compared with expected benefit outlays—the result, in part, of revised estimates concerning the number of covered workers, their average annual wage, and their average retirement age. The Treasury's report suggested that "the estimated discrepancy . . . between future costs and future income . . . may be well within the margin of error in estimates based upon such assumptions and extending so far into the future."

Social Security Board actuaries in a 1938 report revised their cost estimates by introducing a low-high range. Several important changes were made in their actuarial assumptions. An average annual wage of $900 was assumed instead of $1,100, a retirement age of 66 instead of 67½, and initial coverage of 32 million instead of 25.3 million. The "medium" population estimates of the National Resources Committee were used instead of the population estimates of the Committee on Economic Security. Under these estimates and the tax schedule of the 1935 act, the fund was expected to reach a peak of about $32 billion in 1970 and to decline thereafter to about $19 billion in 1980. To maintain the fund at that level, a Federal subsidy of $2.5 billion each year after 1980, or about 6¼ percent of the estimated 1980 payroll, would be necessary. Alternative estimates used the following contribution percentages: for 1937–39, 2 percent; 1940–42, 3 percent; 1943–45, 4 percent; 1946–48, 5 percent; 1949–51, 6 percent; 1952–54, 7 percent; 1955–57, 8 percent; 1958–60, 9 percent; and for 1961 and thereafter,

* Division of Program Analysis, Bureau of Old-Age and Survivors Insurance.

[1] Senate Resolution 300, 81st Congress, 2d session.

9.22 percent. Under this schedule a reserve fund of about $63.4 billion would be accumulated by 1980; it would remain at that level thereafter with no Government contribution required.[2]

Opposition to the accumulation of a large reserve was not based on the size of the fund implied in the 1938 estimates for a self-supporting program but rested on broader grounds.

Meanwhile, the Social Security Board was conducting research on other policy issues, such as coverage and size of benefits. In 1937 the Senate Finance Committee created an Advisory Council on Social Security. Both the Board and the Council in 1938 agreed on recommendations to change benefit and coverage provisions. One fiscal result of the proposals, it was pointed out, would be an increase in the total benefits payable while the program was growing and a decrease in those payable at its maturity, which would flatten somewhat the rising curve of benefit disbursements.

The 1938 Advisory Council based its financial recommendations on the principle that costs should be shared approximately equally by employers, employees, and the Federal Government. It urged accumulation of a "reasonable contingency fund," reconsideration of the contribution schedule at a later date, and study of the timing of the suggested Government contribution.[3] The Social Security Board also supported the proposal for an eventual Government contribution and indicated that only a small reserve would be accumulated under the suggested benefit structure.[4]

The pros and cons of reserve accumulation were widely discussed from 1935 to 1939. Most of the important issues debated were raised again after the 1939 amendments had been adopted. Some questions, however, ceased to receive attention because of the changes in the debt and budgetary situation of the Federal Government. Fear had been expressed, for example, that building up a large reserve would automatically result in a large national debt that could never be eliminated. As the Federal debt expanded during World War II, the likelihood of its complete retirement became increasingly remote. By 1950 it became apparent that continuing defense requirements would add to the already huge Federal debt of more than $250 billion. As a result, arguments based on the idea that complete debt retirement was a possibility became academic. Similarly, the argument that the annual additions to the trust fund would disturb the money markets appeared plausible to many in 1935–39. After 1940, however, the impact of the trust fund on financial markets faded into insignificance when compared with the magnitudes involved in war and defense financing.

1939 Amendments

Most of the Advisory Council's benefit recommendations were incorporated in the 1939 amendments to the Social Security Act; by a narrower definition of agricultural labor, net coverage was, however, slightly reduced. Although some of the Council's financial advice was followed, nothing was done to assure the Federal Government's financial participation in the program—the foundation of all its other fiscal proposals. The 1939 amendments were ambiguous on treatment of the reserve. Conflicting interpretations of their intent with respect to the size of the trust fund added to the vagueness about financial policy. These and other features of the fiscal provisions in the 1939 act were later to produce uncertainties.

The old-age reserve account was changed to the old-age and survivors insurance trust fund, administered by a three-man Board of Trustees, with the Secretary of the Treasury as Managing Trustee. Provision was made for permanent appropriation to this fund of all future contribution receipts. The rate of interest payable on fund investments in special Federal obligations was changed from 3 percent to the average rate on the total Federal debt outstanding at the time of issuance of securities to the fund.

In the 1939 amendments the contribution schedule of the 1935 act was retained, but with one significant change. The step-up in rate from 1.0 to 1.5 percent each for employers and employees, originally scheduled for 1940, was canceled by the amendments, under which the combined contribution rate was to rise from 2 percent to 4 percent in 1943, 5 percent in 1946, and 6 percent in 1949.

Freezing the contribution rate at 2 percent was a policy decision contrary to the recommendation of the 1938 Advisory Council, which had urged that no changes in the contribution schedule be made until after the combined 3-percent rate was in effect. The Council had also recommended that a report be made not later than January 1, 1942, "as to the proper planning of the program of payroll taxes and governmental contributions . . . thereafter." Several members of the Council, however, believed that the increase scheduled for 1940 should not take place until after the proposed study should be made. Edwin E. Witte, a member of the Council, explained at the hearings of the Senate Finance Committee that "in the Council of 25 members, only 5 members voted for the proposal that the tax increase in 1940 should not take effect. Only 2 members noted their dissent on the record."[5] J. Douglas Brown, chairman of the Council, in support of the Council recommendation that the rate be increased to 3 percent in 1940, declared that freezing the rate would be "unsound as a matter of public understanding of contributory insurance."[6]

The contribution rate schedule adopted in 1939 was one of four alternatives submitted to the House Ways and Means Committee by the Secretary of the Treasury without specific recommendations. The Secretary did question the 1935 schedule, however: "In periods of incomplete business recovery like the present, the . . . system should be so financed as to have the least possible deterring effect on business. It is therefore, a pertinent

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[2] W. R. Williamson and R. J. Myers, *Revised Cost Estimates for Present Title II* (Actuarial Study No. 12), October 1938.

[3] *Final Report of the Advisory Council on Social Security,* December 10, 1938, pp. 48–50.

[4] *Proposed Changes in the Social Security Act: A Report . . . to the President and Congress of the United States,* December 30, 1938, pp. 12–13.

[5] *Hearings on H.R. 6635,* (76th Cong., 1st sess.), June 1939, p. 248.

[6] *Social Security, Hearings,* House Ways and Means Committee (76th Cong., 1st sess.), March 1939, p. 1221.

question whether a substantial increase in the tax rate should be allowed to occur at the present stage of business recovery." The reports of the House and Senate Committees on the 1939 amendments give no specific reasons for the freeze in the contribution rate. Their references to the "savings" that would result in 1940, 1941, and 1942 do suggest that the economic effects on business were more influential considerations than internal social insurance factors. The decision to freeze ran contrary to the advice of the Council chairman concerning long-range financial policy for the program.

> It seems to me we should not make the old-age security program the tail on the dog by rapid variations in fiscal policy . . . to make . . . contributions adjustable to control inflation . . . to avoid deflation. They are part of the long-range social security program. I think we should stick to a long-range program as justified from social insurance reasoning and not alter those from year to year according to the precise business conditions of the year.

Among the financial provisions of the 1939 amendments was a requirement that the Trustees report to Congress whenever the fund appeared likely to exceed "three times the highest annual expenditures anticipated" during the next 5 years. This provision reflected a proposal made during the hearings on the bill that the future size of the reserve fund be limited to an amount determined by this so-called "rule of three." At the time this reporting provision was inserted in the act, Congress had before it cost estimates indicating that the fund would probably amount to less than three times the annual expenditures through 1955. These estimates later were found to have overstated benefit expenditures and understated contribution revenues, since the fund increased so rapidly that each year beginning in 1940 it exceeded the maximum to which it would have been limited if the "rule of three" had been applied. While opponents of the accumulation of a large reserve fund continually pointed to this situation, Congress took no action to reduce the size of the reserve to an amount in strict conformity with the provision.

In the 1944 hearings on the wartime freezes before the House Ways and Means Committee, the Chairman of the Social Security Board pointed out that the law required only a report to Congress when the trust fund exceeded three times the highest annual benefit expenditures expected during the next 5 years. Mr. Altmeyer explained that "the law does not require Congress to take any action upon the receipt of such a report, nor does it suggest that the three-times rule is the sole indicator of the proper size of the reserve." The Social Security Board also took the position that the rule was not intended for application in the early years of the program and that "it would be meaningful only with respect to the reserve when the benefit load has reached a considerable degree of stability." The Board also stressed the fact that the Secretary of the Treasury had recommended use of the rule in connection with an "eventual" reserve.

Issues Since 1939

After 1939 the financial amendments to the old-age and survivors insurance program included provisions that froze the combined contribution rate at 2 percent for periods of 1 or 2 years, set up new contribution schedules enacted in 1947 and 1950, and dealt directly with long-range financial policy by authorizing a Government contribution to the program.

The first wartime freeze of the contribution rate was part of the revenue act revision of 1942 and was effective for the calendar year 1943. The second wartime freeze, for the calendar year 1944, was included in the Revenue Act of 1943, passed over President Roosevelt's veto. The rates were held at 2 percent for the calendar year 1945 by a separate amendment to the Federal Insurance Contributions Act. In the Revenue Act of 1945 the freeze was continued for the calendar year 1946. Freezes for the calendar year 1947 and for the 2 years 1948 and 1949 were provided in the Social Security Act Amendments of 1946 and 1947, respectively.

Adherence to the 1939 contribution schedule was requested by the Social Security Board on grounds of long-range social insurance policy. The Board feared that holding the rates at lower levels would weaken the contributory nature of the program by encouraging a belief that benefits need not be paid for by direct contributions. The collateral advantages of a rate increase in helping to finance the war and controlling inflationary pressures were recognized but were held by the Board to be distinctly secondary. Opponents of the rate increases insisted even more emphatically that external considerations were not controlling but disagreed with the position that long-range program factors were of primary importance. They based their case for freezing rates on short-range, internal program factors, particularly the relation of the trust fund to expected benefit expenditures for the next 5 years. Many advocates of a limited contingency reserve took the position that their policy had been put into effect by the 1939 amendments and that the contribution schedule should be changed to harmonize with that policy.

At the 1943 Senate hearings, Mr. Altmeyer, in his statement opposing the freeze, emphasized the lack of "sufficient recognition on the part of the contributors of the real value and cost of the protection," which he described as "substantially in excess of the rate of contributions now being collected." When he opposed the freeze for 1945, Mr. Altmeyer again stressed long-range, internal factors.

> The Board has not undertaken to make any argument from the standpoint of general Government financing or from the standpoint of combating inflationary threats. However . . . most of those who in 1939 opposed the automatic increase in the contribution rate in January 1940 did so largely for reasons not connected with the financing of a contributory social insurance system and emphasized the deflationary effect of the increase. Those arguments advanced in 1940 not only are inapplicable under present conditions, but logically would support an increase . . . now.[7]

Contributions sufficient only for a limited contingency fund, the Board

[7] *Freezing the Social Security Tax Rate at 1 Percent, Hearings,* House Ways and Means Committee (78th Cong., 2d sess.), November 27, 1944, p. 6.

also argued, would be unfair to future generations of contributors. Under a contingency reserve plan, they might have to pay from three to five times as much for the same insurance protection as contributors during the first two decades of the program, since increasing numbers eligible for benefits and higher average benefit amounts would make benefit expenditures much higher than at the program's start. In its first annual report (for the fiscal year ended June 1936) the Board explained that one purpose of reserve accumulation was "the budgeting of the cost according to an orderly plan which will effect a wise distribution between present and future payments."

Although there was some support for the view that contribution rates should be adjusted to the requirements of wartime finance, most of the statements made at congressional hearings emphasized that the requirements of social insurance financing should be given primary consideration.

At the November 1944 hearings, an argument in favor of the rate increase was based on the following reasons. It would (1) reduce the program's actuarial deficit and the total deficit of the Federal Government; (2) earn interest that would eventually be available for benefits; (3) strengthen the contributory character of the program; and (4) be fairer to young workers who will pay social security taxes throughout their lives. Secondary reasons were the help an increased rate would provide in financing the war and preventing inflation.

At the same hearings, M. A. Linton, president of the Provident Mutual Life Insurance Company, commented on arguments that the increase would help finance the war effort or fight inflation: "It is dangerous to use these taxes for extraneous purposes . . . Social security taxes should be applied solely to meet social security needs . . . The social security tax rate should not be altered upward or downward as an economic measure to counteract inflationary or deflationary forces."

Some analysis of the relation of the trust fund to total Federal finances appeared during the course of the discussions from 1940 to 1950.

Charges were frequently made that investment of the reserve fund in Federal bonds involved the misuse of social security moneys through their expenditure for extraneous purposes. It was also asserted that the ready availability of contribution income in excess of current benefit requirements would be a temptation to Federal extravagance. Such charges led the 1938 Advisory Council to declare unanimously that "the present provisions regarding the investment of the moneys in the old-age reserve account do not involve any misuse of these moneys." Ten years later, the 1948 Advisory Council affirmed its unanimous agreement with this statement.[8]

Some opponents of reserve accumulation have also charged that a large fund would lead to unwarranted or extravagant liberalization of benefits. This argument has been countered with the contention that if the program were financed on a current-cost basis the deceptively low contribution rates during the early years would stimulate the very kind of benefit generosity feared by the opponents of a large reserve. After reviewing these conflicting viewpoints, a technical staff of the House Ways and Means Committee concluded that "decisions as to the method of financing had better rest on other grounds than that of making it easy for legislators to resist undue pressures."[9]

Advocates of a limited contingency reserve held that accumulation of a larger fund would serve no fiscal purpose and that interest payments of the fund were equivalent to a Federal subsidy. Some of them argued that taxation to pay interest on bonds held by the trust fund would be double taxation for social security. Opponents of this view declared that it involved a major accounting error, because it counted debt service costs as social insurance costs.

The Senate Finance Committee, reporting on the revenue bill of 1943, used as an illustration an assumed trust fund of $50 billion, with the Government paying $1.5 billion in interest annually. It declared that "it makes no difference to the taxpayer whether this $1,500,000,000 is appropriated to pay the interest on $50,000,000,000 of Government bonds in a reserve fund or whether it is a direct appropriation." The advocates of fund accumulation replied that interest would have to be paid on the Federal debt whether or not the bonds were held by the old-age and survivors insurance trust fund, and if the bonds in question were not held by the fund, the Government would have to pay a subsidy to the insurance program besides paying the interest on these bonds.

Mr. Altmeyer pointed out in the 1944 House hearings that without the assumed $50 billion fund, the taxpayers would be required to pay $1.5 billion more for debt interest and social security combined than they would have to pay for the same purposes with such a fund.[10] Later, the insurance organizations in a 1945 report, *Social Security,* concurred with Mr. Altmeyer's reasoning about the fiscal savings made possible by building a fund (although they did not advocate reserve accumulation): "a reserve fund therefore makes possible the use of interest, which the Government has to raise by taxation anyway, for a purpose which otherwise would require further . . . taxation on its own account."

The legislative history of the wartime freezes indicates that they were advocated on policy grounds that differed from those used to support the 1939 freeze. The Social Security Board protested consistently that long-range, internal considerations were more important than either external considerations or short-range, internal considerations. The wartime freezes were advocated on the basis of short-range, internal factors in contrast to the external considerations advanced in 1939.

These freezes were on a temporary, year-to-year basis. In 1947, new contribution schedules based more fully on considerations of long-range financial policy were proposed. The contribution schedule finally adopted in that year, however, provided for a 2-percent rate for 1948 and 1949 and was

[8] Senate Document No. 149 (80th Cong., 2d sess.), April 20, 1948, p. 48.

[9] *Issues in Social Security: A Report to the Committee on Ways and Means . . .* 1946, p. 119.

[10] See also George B. Robinson, "Accounting Error in Social Security," *Journal of Accountancy,* November 1944. There is no record showing that anyone has challenged the validity of this reply to the Senate Committee's argument.

essentially a stop-gap measure. It was generally believed that the increase to 3 percent scheduled for 1950 (and the subsequent increase to 4 percent set for 1952) would be subject to change if coverage and benefit provisions were later amended. This schedule differed from the 1939 schedule chiefly in its maximum rate—4 percent instead of 6 percent.

The 1947 contribution schedule was really a compromise between the arrangements recommended by the House Ways and Means Committee and those proposed by the Senate Finance Committee. Both committees recommended continuation of the 2-percent rate through 1949. The House Committee proposed an increase to 3 percent in 1950 and still another increase to 4 percent in 1957,[11] but the Senate Committee said that they considered it "advisable to postpone consideration of rates beyond 1949 until there can be further study and investigation of the coverage, benefits, and other aspects of the social security program, and the taxes related thereto." [12] In the legislation finally enacted the contribution schedule rose to 4 percent, but it was to reach that rate in 1952 instead of 1957, the year recommended by the House Committee.

Formal authorization of a Government contribution to the program resulted directly from the congressional debate on the rate freeze for calendar 1944 and indirectly from the discussion of financial policy that has been continuous since the adoption of the original act. In 1944 the following sentence was added to section 201(a) of the Social Security Act: "There is also authorized to be appropriated to the Trust Fund such additional sums as may be required to finance the benefits and payments provided under this title." [13]

In recommending that the social security contribution rate again be frozen in 1944 the Senate Finance Committee had declared in 1943 that "Congress obligates itself in the future to make whatever direct appropriations . . . are necessary to maintain the full and complete solvency of the . . . benefit funds, because there could be no more solemn public trust." Because the amendment authorizing the subsidy was introduced by Senator James E. Murray, his comments during the 1944 debate give an authoritative interpretation of the policy significance of this provision:

> The least that Congress should do now to protect the financial integrity of the system is to incorporate a provision in the Social Security Act itself, immediately and explicitly authorizing a Government subsidy. This would replace revenues lost to the fund through congressional action in scaling down the scheduled contributions. I assume that the Finance Committee would have no objection to such an amendment since its report states that Congress has already obligated itself to provide subsidies. Such an amendment would ensure that the finances of the program would not be endangered by past and projected freezings of the tax rate. It would also provide statutory recognition of the process which is actually taking place, namely, the process of shifting to future taxpayers most of the cost of benefits now being earned by present contributors. At the 1 percent rate, present contributors, together with their employers, are paying only a fraction of the full cost of their benefits. Congress should not adopt so imprudent a fiscal policy; but if it does, Congress should make sure that it is not adopted at the expense of future beneficiaries.[14]

An unsuccessful attempt to repeal this authorization was made in 1946 in the House version of the 1946 bill amending the Social Security Act.[15] The Senate Finance Committee, however, held that "to repeal this provision, as proposed by the House of Representatives, while continuing to freeze the tax, might be taken to imply an unwillingness of Congress to underwrite the solvency of the system."[16] The Finance Committee's decision finally prevailed,[17] and the authorization of a Government contribution remained in the basic legislation until passage of the 1950 amendments.

During the hearings and discussions many advocates of a limited contingency reserve indicated that they expected a future Federal subsidy to take the place of a larger fund. The Senate Finance Committee, for example, declared in 1943 that a future Government contribution "is inherent in the decision made by Congress in 1939," a decision that it interpreted as a move to "change to the basis of contingent reserves." When it became apparent that contribution rate increases would not be approved, the advocates of greater reserve accumulation were able to cite this declaration in support of the subsidy authorization noted above. Although some Members of Congress held that a Government contribution would be inequitable to general taxpayers as long as coverage of the program remained limited, their views did not prevail.

Many advocates of a future Government contribution concurred with the reasoning of the 1938 Advisory Council, which pointed out that, with a Federal subsidy, employer-employee taxes would not have to rise to such a high ultimate level as in the 1935 contribution schedule. They reasoned that the upward slope of the contribution-rate curve would be less sharp if a future Government contribution was assumed. Since such a subsidy would, with respect to program revenues, take the place of interest earnings from reserve funds, there would be less need to accumulate sizable funds. Hence, successive increases in the contribution rates might be smaller in amount and separated by longer time intervals than those called for if there were to be no Government contribution.

Opponents of this view stressed the fact that these decisions to postpone contribution increases, to rely on a future Government subsidy, and therefore to accumulate smaller reserves would not mean any lightening of future fiscal burdens. The total cost of benefits in any future year would be the same amount of dollars, whether that total was divided among three sets of taxpayers or two sets. According to this view, the decision

[11] House Report No. 594 (80th Cong., 1st sess.), June 16, 1947, p. 1.

[12] Senate Report No. 477 (80th Cong., 1st sess.), July 11, 1947, p. 3.

[13] *Revenue Act of 1943,* February 25, 1944.

[14] *Congressional Record,* January 11, 1944, p 46.

[15] House Report No. 2526 (79th Cong., 2d sess.), July 15, 1946, pp. 3, 14.

[16] Senate Report No. 1862 (79th Cong., 2d sess.), July 27, 1946, p. 3.

[17] House Report No. 2724 (79th Cong., 2d sess.), August 1, 1946, pp. 1, 5.

in favor of a Government contribution was an answer to the question: Who shall pay the cost of the benefits? It was a decision to divide these costs among general taxpayers, employers, and employees, rather than between the two latter groups.

The amount of the reserve funds to be accumulated was, however, a "when" question: When shall the cost be borne? It involved the timing of contributions. The decision to place part of the costs on the general taxpayer left unanswered the question as to when the Government contribution should begin. It did not face the real issue raised by the advocates of reserve accumulation who held that if more contribution revenue were collected in early years, less would have to be collected in later years. With a larger reserve fund accumulation, total contribution levies needed in the future would be smaller because of the compounding of interest earned by reserve funds.

Postwar Studies

After World War II ended, the House Ways and Means Committee and the Senate Finance Committee each initiated studies of social security finance and general policy. The House study, *Issues in Social Security,* was made in 1946 and includes a comprehensive analysis of the issues in old-age, survivors, and extended disability insurance. The study sponsored by the Senate Finance Committee was made by an Advisory Council on Social Security organized by the Committee in 1947. This advisory council in its report in 1948 made 22 recommendations for legislative changes in the old-age and survivors insurance program and gave the reasons for the proposals.[18] It later issued a similar report on disability protection,[19] in which the recommendation is made that such a program be the responsibility of the Bureau administering old-age and survivors insurance.

In one sense, the report of the 1948 Advisory Council begins where that of the technical staff of the House Committee stops. From the pros and cons of the alternatives presented by the technical staff of the House Committee and from supplementary data, the Council selected its concrete proposals and its justifications for them. Technically, these reports are not official reports of the respective congressional committees, nor do the views express the formal conclusions of the committee memberships. They are reports to the committees, not reports by or of the committees.

Two differences in emphasis on financial issues appear in these reports. The technical staff of the House Committee suggested a long-range contribution schedule that provided for a 0.5-percent rise in both the employer and employee contribution rate every 10 years up to 1977. The 1948 Advisory Council recommended an increase in the combined contribution rate to 3 percent whenever its other proposed changes should become effective, but it suggested that the timing of future rate increases be governed by the following principles.

> The next step-up in the contribution rate, to 2 percent on employer and 2 percent on employee, should be postponed until the 1½-percent rate plus interest on the investments of the trust fund is insufficient to meet current benefit outlays and administrative costs. There are compelling reasons for an eventual Government contribution to the system, but the Council feels that it is unrealistic to decide now on the exact timing or proportion of that contribution. When the rate of 2 percent on employers and 2 percent on employees plus interest on the investments of the trust fund is insufficient to meet current outlays, the advisability of an immediate Government contribution should be considered.

The Council explained why it believed a Government contribution should be paid. It pointed out that full-rate benefits would be paid to retirants during the first two or three decades of operation, even though these retirants (and their employers) could have paid only a part of the costs. Because it would be inequitable to ask employers and employees to pay "the entire cost of liabilities arising primarily because the act had not been passed earlier than it was," this burden should be assumed by the Federal Government. A Government contribution would be appropriate because the substitution of social insurance for part of public assistance would lighten the load of taxation for assistance. It would, moreover, "be a recognition of the interest of the Nation as a whole in the welfare of the aged and of widows and children." The first of these reasons is substantially the same as that given in support of a Federal contribution by the Committee on Economic Security in its 1935 *Report to the President.*

1950 Amendments

In January 1949, Congress began consideration of extensive amendments to the Social Security Act.[20] A bill, H.R. 2893, introduced early in the first session of the Eighty-first Congress, incorporated many of the recommendations of the 1948 Advisory Council. After lengthy hearings, the House Ways and Means Committee rewrote this bill and reported it out as H.R. 6000.[21] Following passage by the House, a revised version of H.R. 6000 was reported out by the Senate Finance Committee[22]; a joint conference committee recommended its passage substantially as revised by the Senate.[23] On August 28, 1950, the bill was approved.[24]

In its financial policy, H.R. 2893 embodied many of the recommendations of the 1948 Advisory Council. Its contribution schedule provided only two specific increases in the combined employer-employee rate. The first increase, from 2 to 3 percent, would become effective when benefits were liberalized. The second increase, to 4 percent, intended to cover the cost of temporary disability benefits, would become effective 6 months later. The bill retained the authorization for a Government contribution. The maximum amount of annual earnings subject to social security taxes was raised from $3,000 to $4,800.

Cost estimates for this bill prepared by Social Security Administration

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18 Senate Document No. 149 (80th Cong., 2d sess.), April 20, 1948.

19 Senate Document No. 162 (80th Cong., 2d sess.), May 27, 1948.

20 For a summary and legislative history of the 1950 amendments, see the *Bulletin* for October 1950.

21 House Report No. 1300 (81st Cong., 1st sess.), August 22, 1949.

22 Senate Report No. 1669 (81st Cong., 2d sess.), May 17, 1950.

23 House Report No. 2771 (81st Cong., 2d sess.), August 1, 1950.

24 Public Law 734.

actuaries made possible two alternative plans for scheduling the Government subsidy.[25] In the first plan the Government contribution would begin about 1960 (low-cost estimates) or 1954 (high-cost estimates), when income from private contributors, plus fund interest, would be exceeded by disbursements. This plan assumes that the subsidy would be sufficient to keep the trust fund from decreasing. The combined employer-employee contribution rate would be maintained at 3 percent until the Government contribution exceeded half the revenue from private contributors; the employer-employee rate would then be increased to 4 percent. A combined rate of 5 percent would become effective in 1979, under low-cost estimates; and a combined rate of 9 percent in 1993, under high-cost estimates. The Government contribution in 2000 would be about $4 billion under low-cost estimates and about $6.5 billion under high-cost estimates.

In the second plan, the combined employer-employee contribution rate would be increased from 3 to 4 percent when the revenue from private contributors, plus fund interest, was exceeded by disbursements. When contribution income from the 4-percent rate, plus fund interest, became insufficient, the Government contribution would be introduced. As in the first plan, the amount of the subsidy is assumed to be sufficient to keep the trust fund from decreasing. A combined rate of 5 percent would become effective in 1980, under low-cost estimates; and a combined rate of 9 percent in 1993 under high-cost estimates. The amount of the Government contribution would be the same in 2000 as under the first plan, but under low-cost estimates the timing of its inauguration would be different —about 1970 instead of 1960. Under high-cost estimates the Government contribution would start about 1957, slightly later than in the first plan.

After extensive hearings, followed by protracted consideration in executive session, the House Ways and Means Committee drafted and reported favorably H.R. 6000, which differed fundamentally in financial policy from H.R. 2893 because it eliminated the authorization for a Government contribution. The Committee believed that the program "should be on a completely self-supporting basis." In harmony with this decision, it wrote into H.R. 6000 a complete contribution schedule designed to finance the benefits in perpetuity. This schedule provided for the following combined rates: for 1950, 3.0 percent; 1951–59, 4.0 percent; 1960–64, 5.0 percent; 1965–69, 6.0 percent; and for 1970 and thereafter, 6.5 percent. Contribution rates for the self-employed would be one and one-half times as much as employee rates.

The Committee's actuary estimated that as a result of this self-supporting contribution schedule, the trust fund would grow rapidly for at least two decades and more slowly for two more decades. By 1960, the trust fund would amount to $33 billion; by 1970, $53 billion; by 1980, $71 billion; and by 1990, about $74 billion.[26] These were intermediate estimates based on a 2-percent interest rate. Preliminary estimates, derived from slightly different wage assumptions, had been presented earlier in the Committee report.

During the early years the contribution rates under the Ways and Means Committee's bill would be lower than the estimated level premium cost of the program, and after 1970 they would be slightly higher. The Committee said in its report that it did "not recommend that the system be financed by a high, level tax rate from 1950 on but rather . . . an increasing schedule, which—of necessity—will ultimately have to rise higher than the level-premium rate."

The Committee commented as follows on the size of the trust fund:

> In evaluating the ultimate size of the trust fund, there should be kept in mind the fact that the liabilities of the system likewise are correspondingly large. Fifty years hence estimated benefit payments . . . will be almost $12,000,000,000 per year; the actuarial liability for the benefits then in current payment status (disregarding those which will fall due or be claimed thereafter) will be $100,000,000,000 to $125,000,000,000, and an insurance company would have to hold reserves of comparable amounts to meet its legal liability under similar circumstances.

The treatment of the trust fund in the Committee report was apparently a byproduct of the decision to make the program self-supporting without a Government contribution. The report expressed no fear of the relatively large reserve that would result from this policy and from the related decision that the maximum contribution rate should be reached by 1970.

H.R. 6000 differed from H.R. 2893 also in the maximum wage base for contributions and wage credits—$3,600 instead of $4,800. The new base was, however, $600 more than the $3,000 base in effect until 1951.

The Senate Finance Committee held its hearings on H.R. 6000 in 1950, and in reporting the bill with amendments it made two important changes in the financial provisions. It maintained the maximum wage base for contributions and wage credits at $3,000 instead of the $3,600 in the House bill, and it also changed the contribution schedule by postponing the starting date for the combined employer-employee contribution rate of 4 percent from 1951 to 1956. While thus reducing the contribution income of the trust fund, the Committee increased the disbursements to be made in the near future by changing eligibility requirements so that about 700,000 additional beneficiaries would be added to the rolls almost immediately. The effect of these changes would be to slow down reserve accumulation until 1956.

Consequently, even though under the bill reported to the Senate the combined contribution rate ultimately would rise to 6.5 percent, as under the House bill, the 1990 peak of the trust fund was estimated at $72 billion—about $2 billion less than the 1990 peak of $74 billion estimated under the House bill.[27] Most of the difference in these peak amounts resulted from

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[25] Robert J. Myers and E. A. Rasor, *Long-range Cost Estimates for . . . H.R. 2893* (Actuarial Study No. 28), February 1949, pp. 18-21.

[26] Robert J. Myers, *Actuarial Cost Estimates for . . . H.R. 6000,* October 3, 1949, p. 14.

[27] These figures are based on intermediate costs. The high-low ranges, from which these intermediate costs were derived, are in the actuarial reports on H.R. 6000.

differences in estimated trust-fund operations before 1956. The Senate Committee's report, on the basis of the final estimates for the House version of H.R. 6000, said: "Thus under the House-approved bill, according to the intermediate estimate, the Trust Fund increases to $25 billion by the end of 1955 as compared with $17½ billion at the same date for the Committee-approved bill; this difference of about $8 billion is maintained for almost 25 years."

Shortly before the final Senate vote on H.R. 6000, the Senate Finance Committee, in a reversal of its earlier recommendation, introduced an amendment that restored the increase in the wage-base maximum from $3,000 to $3,600. The Senate passed the bill with this amendment incorporated. Before final action on the bill, the Senate appropriated $25,000 for further study by its Finance Committee of ways to improve the program, especially with respect to coverage and finance.

In the bill reported by the Conference committee and finally enacted, one important change from the House and Senate versions of H.R. 6000 was a compromise on the contribution schedule. In the House version, the increase to the 4-percent rate was scheduled for 1951; in the Senate version, for 1956. In the amendments enacted into law, the effective date is 1954. The amendments also retain the $3,600 wage-base maximum and the provision repealing the authorization of a Government contribution.

Published records of committee hearings and of congressional debates associated with the 1950 amendments contain no mention of the "rule of three." Estimates for the program before these amendments indicated that the trust fund in 1950 would be 9 or 10 times the highest expected annual disbursements during the next 5 years. Intermediate estimates of the progress of the trust fund under the 1950 amendments show that the reserve will be in excess of the maximum permitted by the "rule of three" throughout the period for which estimates have been made. At its peak about 1990, the estimated trust fund of about $83.5 billion would be about eight times the highest expected annual disbursements during the next 5 years.[28] Congress, however, took no action to eliminate, modify, or clarify the requirement that the Board of Trustees shall report whenever the trust fund exceeds three times the highest annual expenditures anticipated during the next 5 fiscal years. If this provision is interpreted as establishing a mandatory or desirable maximum, it is in conflict with the contribution schedule of the law as amended in 1950. If it is merely a requirement for a report, it would seem to be superfluous; the regular Trustees' reports would indicate how much the existing trust fund might exceed the maximum required on a contingency fund basis.

Future Financial Policy

The foregoing historical summary lends weight to the conclusion that the 1950 amendments provide no final answer to the problem of financing old-age and survivors insurance. Since a review of the basic financial issues by the Senate Finance Committee is expected to begin in 1951, the recently enacted provisions will be subject to wide public discussion shortly after they have become effective. The extended coverage of the amended program will add to the number of people who have a direct interest in the decisions reached.

The issues probably will continue to center on the schedule of contribution rates and the size of the reserve fund. The merits of current-cost as against level-premium financing will be further debated, together with proposals for partial reserves accumulated under intermediate solutions such as the use of the actuarial rate.[29] An inseparable question will be the desirability or necessity of a Government contribution or subsidy. The issue of the wage-base maximum probably will be reopened.

The problem of program financing will take on new aspects if serious consideration is given to proposals for fundamental changes in the benefit structure of the program. Schemes for noncontributory pensions, particularly those that include a means test, not only would differ basically from the present program in their benefit aspects but also would have far-reaching implications from the standpoint of financial policy. Proposals that would combine in one program flat pensions to all the aged and additional insurance benefits payable only to insured workers involve complex financial issues. M. A. Linton, for example, has proposed that each retired person over 65 years of age be eligible for a minimum monthly pension of $25 and that an additional insurance benefit, related to earnings in covered employment, be paid in accordance with a suitable formula "up to a relatively low maximum."[30] Helen Gahagan Douglas, then Representative from California, suggested a noncontributory pension of $75 a month, supplemented by a contributory insurance benefit computed as 15 percent of the worker's average monthly wage.[31]

Either noncontributory pensions or a combination of noncontributory flat pensions with supplementary insurance benefits might properly use methods of financing fundamentally different from those applicable to the existing program. Thus, future financial policy will depend in large part on the kind of insurance program that is finally adopted.

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[28] Robert J. Myers, *Actuarial Cost Estimates for . . . Amendments of 1950*, July 27, 1950. The report explains the high-low range from which the intermediate estimates were derived and discusses the way in which the contribution schedule aimed at the principle of self-support, but it does not secure an exact balance using integral or rounded fractional rates.

[29] See Robert M. Ball, "What Contribution Rate for Old-Age and Survivors Insurance?" *Social Security Bulletin*, July 1949.

[30] *Social Security Revision, Hearings*, Senate Finance Committee (81st Cong., 2d sess.), February 1950, p. 961.

[31] H.R. 7617 (81st Cong., 2d sess.), March 8, 1950.