Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 17, 1939.

To Chairman Eccles

Subject: Old Age Security Program

From Lauchlin Currie

LBC

In accordance with your instructions, I sent a copy of the attached memoranda on social security to Secretary Hopkins today.

March 17, 1939.

BROAD CASE FOR DRASTIC AMENDMENT OF THE PRESENT OLD AGE SECURITY PROGRAM

The present program is defective on both social and economic grounds. It very obviously fails to meet the social need, as is evidenced by the attitude of the overwhelming bulk of the voters. The present old-age pensions are totally inadequate in some states, and the rigid means test as applied to the families of the aged is resented.

On economic grounds, the present program is even more open to criticism. The pressing overall economic problem facing us is that of excessive capacity to save relative to investment outlets, or stated in other terms, an acute deficiency of consumer buying power relative to our capacity to produce. The payment of old age pensions, financed in part from the general income tax base, provides the obvious solution to our economic problem. It fits in with the community's prevailing ideas as to social justice and involves a minimum of interference with or departure from the set of ideas associated with our system of private enterprise and a profit economy. Generalized old age pensions are a feature of other capitalistic democracies.

In place, however, of utilizing this favorable social attitude as a means of solving our economic problem, we have actually intensified that problem by devising a scheme of tax collections in relation to benefit payments that entails a substantial decrease in consumer buying power. On the old age insurance part of the present program we will, in the years 1937-39, have withdrawn about \$1.7 billion from consumer buying power. In 1940 the danger of a deficiency in consumption will become especially acute. In that year, however, the tax rate on old age account will rise by fifty percent, coverage will be extended, and, assuming no more than a 1937 level of payrolls, tax accruals will grow to around \$900 million, from \$550 million in 1939. The net deduction from buying power will not only be large in absolute terms, but will be larger than in 1939.

The basic economic defect of our old age program lies in its failure to take cognizance of the changed economic environment relative to savings and the outlets for savings. Throughout the major part of our history our savings were almost automatically translated into capital expenditures and hence added to our standard of living. In addition, the outlets were such that we borrowed from abroad.

The present system of old age insurance, envisaging an excess of tax collections over benefits for many years to come and hence a net addition to the volume of current savings, is based implicitly on the assumption that such saving will add to our productive facilities, will add to our annual production of goods and services, and hence will permit the older people to be paid without tending to lower the standard of living of the rest of the community.

The moment it is seen that additional savings, so far from resulting in an increase in annual production, merely means that we have less of an effective demand for the output of our existing productive facilities, the economic argument for the existing method of financing old age security collapses.

The remaining argument for the present system is a political-social one. It is believed that adherence to a particular schedule of tax rates and increases is necessary for the maintenance of the contributory principle of old age insurance. The contributory principle, in turn, is regarded as necessary to (a) provide a basis for the differences in individual benefit payments necessary in a country with such wide income differences, (b) do away with the means test and (c) safeguard scales of benefit payments against reductions by some future Congress.

The various links in this argument must be considered separately:

(a) It is difficult to see that the contributory principle is tied up with any <u>particular</u> schedule of tax payments except one in which every beneficiary receives back an amount proportional to what he paid in. Actually this is not now provided, and further departures were proposed by the Social Security Advisory Board. In any case, the bulk of the levy on the employer is either passed back or passed on to the consumer, so that today the general consuming public, including farmers, domestics and people over sixty-five, is being taxed to provide benefits for particular workers in covered occupations. This is freely admitted, but it is said that the important thing is that people should <u>feel</u> that they are entitled to an annuity because they have paid premiums in the form of taxes. The argument at this point, however, becomes excessively finespun when this psychological attitude is tied up with any <u>particular</u> rate of taxes, and any <u>particular rate of increase</u> in such taxes.

It is doubtless desirable that future beneficiaries should be conscious of the fact that they are currently paying old age taxes roughly proportional to their incomes. This helps to justify differences in annuity payments and to avoid the test of dire need to qualify for such annuities. However, a generalized percentage payroll or income tax accomplishes this, whether it covers one-third of the current cost of annuities, as in England, or a much larger percentage of the cost, as our present program provides.

(b) With reference to the argument that adherence to a particular schedule of rates and increases safeguards particular schedules of annuities from change by future Congresses, it may be pointed out that the act passed in 1935 is already undergoing extensive revisions. It is naive to expect that through various devices we can safeguard an institution or social program from change. What people over sixty-five will receive in the year 1960 depends on a host of factors we cannot even visualize.

March 17, 1939.

SOCIAL SECURITY PROGRAM FOR 1940

Now that the Social Security Act is up for revision an effort should be made to devise a plan that would

(a) meet the widespread demand for national old age pensions,

(b) permit differentials in monthly payments in different parts of the country,

(c) preserve the contributory principle,

(d) make for an addition to rather than a subtraction from consumer buying power,

(e) entail no additional appropriations nor taxes over those now contemplated for 1940.

Such a plan, if it can be worked out, would remove the old age pension issue from politics in 1940, would prevent the threatened deficiency in consumer buying power in 1940, and yet could not be opposed on economy grounds.