Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date March 6, 1940

To Chairman Eccles

Subject: Notes on Social Security

From Emile Despres

As you requested some weeks ago, I have been familiarizing myself with the detailed provisions of our social security legislation, in an effort to find some immediately practicable and effective measures for removing the deflationary effects of the present system. Although I have not been altogether successful in this search, you may be interested in the attached memorandum, which provides figures showing the draft upon incomes involved in the present system, and discusses some possible lines of action.

Attachment

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March 6, 1940

NOTES ON SOCIAL SECURITY

The estimated balances in the old-age and survivors insurance trust fund and in the unemployment trust fund on June 30, 1940, December 31, 1940, and June 30, 1941 are shown in the following table, together with the actual balances in these funds on December 31, 1939:

(In millions of dollars)

	Old-age	Unemployment	Total
Dec. 31, 1939	1,442	1,510	2,952
June 30, 1940	1,753	1,797	3,550
Dec. 31, 1940	2,032	2,097	4,129
June 30, 1941	2,333	2,382	4,715

According to these estimates the accumulated balances in the old-age and survivors insurance trust fund and in the unemployment trust fund will each grow at the rate of nearly $50 million a month during the period covered by the table. The estimated receipts and expenditures of these funds from the end of 1939 to the middle of 1941 are as follows:

(In millions of dollars)

	Receipts			Expenditures			
	Contri-butions	Interest	Total	Bene-fits	Admin-istra-tion	Total	Net Receipts
a. Old-age							
1940-1st half	296	43	339	15	13	28	311
1940-2nd half	329	--	329	35	15	50	279
1941-1st half	316	65	381	65	15	80	301
Total	941	108	1,049	115	43	158	891
b. Unemployment							
1940-1st half	460	37	497	210	--	210	287
1940-2nd half	470	20	490	190	--	190	300
1941-1st half	465	30	495	210	--	210	285
Total	1,395	87	1,482	610	--	610	872
c. Old-age plus Un-employment							
1940-1st half	756	80	836	225	13	238	598
1940-2nd half	799	20	819	225	15	240	579
1941-1st half	781	95	876	275	15	290	586
Total	2,336	195	2,531	725	43	768	1,763

The excess of social security tax receipts over benefit payments involves a corresponding draft upon community income, and particularly upon the buying power of the lower and middle income groups. Since the groups chiefly affected consume currently all or nearly all of their income, this draft upon incomes directly produces a nearly equivalent contraction in the volume of consumer purchasing; when account is taken of the indirect, cumulative effects of this primary curtailment of consumer demand in diminishing incomes and activity in the consumer goods industries and in reducing their need for making capital outlays, the total curtailment of national income attributable to the piling up of idle reserve funds is substantially larger and greatly exceeds in amount the current additions to these funds.

The marked restrictive effect upon national income exerted by our present social insurance system could be relieved by any measure which (1) reduced taxes payable into the trust funds, (2) increased benefits chargeable to such funds, or (3) permitted accumulated reserves to be used in financing new public projects which would not otherwise be undertaken. Action along one or more of these lines would now be particularly useful in that it would provide a stimulus to national income, output, and employment without increasing the Treasury's budgetary deficit; action on a substantial scale would, in fact, materially reduce the Treasury's deficit through the effect of higher national income in raising tax revenues.

Old Age

Any proposal to reduce payroll taxes or introduce comprehensive coverage for old-age pensions would be regarded as running counter to the "contributory principle", and the specious attractiveness of this phrase constitutes a chief obstacle to adequate revision of the existing old-age pension system. Since the 1939 liberalizing amendments to the Social Security Act were supposedly the outgrowth of careful and prolonged deliberation by experts, considerable hesitancy exists about raising these questions so soon again. On the other hand, the polls of public opinion and other indicators have shown that adequate old-age pensions are overwhelmingly popular; it is also likely that lowering of payroll taxes would be warmly welcomed. Despite the reluctance to deal with such matters in an election year, a case can be made out for reopening these issues now.

Assuming that a fight against the "contributory principle" can be successfully waged at this time, two possible lines of action may be mentioned:

1. Lower the old-age payroll tax from 2 to 1 percent until such time as outpayments from the fund become equal to receipts, thereby reducing revenues by over $300 million a year. This would merely retard but would not halt the further accumulation of reserves; such reserves are already adequate to meet contingencies. Half of the old-age payroll tax is explicitly deducted from workers' pay envelopes and the remainder is paid by employers. The reduction in the workers' share of the tax (over $150 million) would provide a direct addition to workers' buying power; the decrease in the tax paid by employers would operate in the first instance chiefly to increase business profits and would be only gradually reflected in higher wages or lower selling prices.

2. Replace the present Federal grants to States for old-age assistance and the contributory benefit payments by a uniform Federal pension of, say, $15 a month to single persons and $25 to married couples, to be paid to all retired persons over the age of 65 whose incomes are not currently sufficient to make them liable for Federal income tax. While the cost of such a program is difficult to estimate, it seems probable that outpayments would not greatly exceed the sum of payroll tax receipts plus amounts currently being expended by the Federal Government for old-age assistance. By reducing the need for State and local outlays for old-age assistance, which are running at about $215 million a year, a comprehensive Federal system of old-age pensions would also provide relief to State and local budgets.

If it is not feasible either to reduce payroll taxes or adopt a flat pension for all old people in the lower income groups, the only means of reducing substantially the draft on incomes involved in the present system would be through investment of reserve funds in socially beneficial public projects of a sort which would not otherwise be undertaken. The receipts accruing to the old-age and survivors insurance trust fund, instead of being returned to the Treasury in exchange for special Treasury securities, might be used for such purposes as expanded public construction of workers' houses, construction of hospitals, or rural resettlement and rehabilitation programs. If the accumulation of reserves is to continue, it is appropriate to hold that these funds should be invested in ways which will directly add to the country's durable assets and that these assets should be of a type which will particularly benefit the groups which bear the cost of payroll taxes. If the "contributory principle" is to be retained, this change in investment procedure would do a good deal to mitigate its adverse effects on buying power and national income.

Of the methods discussed above for relieving the deflationary effects of the present old-age pension system, reduction of payroll taxes would be most prompt in producing some effects. The administrative tasks involved in a changeover from the present system of assistance and contributory benefits to a flat pension would doubtless make it impossible to begin payments on the new basis much before the beginning of 1941, while a change in the method of investing the trust fund could scarcely result in increased public construction activity until next year.

Unemployment

Our brief experience with unemployment insurance has already shown clearly that the relationship between taxes and benefits is seriously unbalanced. The balance in the unemployment trust fund at the beginning of 1940 was nearly four times estimated 1940 benefit payments, and such payments will, it is estimated, provide outlets for only 40 percent of the fund's receipts during 1940. Under these circumstances employers' groups are pressing for a reduction in taxes while organized labor of both the A.F. of L. and C.I.O. camps is urging liberalization of benefit provisions.

In most States unemployment insurance taxes are levied on the employer. Since tax reductions would not be immediately passed along to workers or consumers, and because the advocacy of increased unemployment insurance benefits is one point on which the A.F. of L. and C.I.O. agree, the Federal Government can best lend its support to the movement for liberalization of benefits.

It is in respect to duration of benefits and waiting period rather than to rate of weekly benefit that the State unemployment insurance systems are chiefly defective. The period for receiving benefits varies from three to sixteen weeks, as contrasted with a duration period of about twenty-six weeks under the British system. The waiting period in this country, though varying greatly from State to State, probably averages between two and three weeks.

A bill (H.R. 7762) introduced in the House by Representative McCormack provides for (1) the establishment of minimum insurance benefit standards, (2) further liberalization of benefits combined with lowering of taxes in States which, after having fulfilled these minimum standards, continue to show a surplus of receipts over outpayments, and (3) a re-insurance fund to reimburse States whose tax collections and accumulated reserves are insufficient to maintain benefits in accordance with the minimum standards set by the bill. Since most State legislatures do not meet in 1940, July 1, 1941 is fixed in the bill as the deadline for putting these minimum standards into effect. These standards include a benefit period of at least twenty weeks, a waiting period of not over one week, and a weekly rate of compensation equal to 60 percent of full time weekly earnings. Although the bill may require revision in some particulars, the general character of its approach to the problem of correcting the defects in present State unemployment insurance systems seems sound, and its provision for a reinsurance fund would be a first step in the transition to a unified Federal system of unemployment insurance.