Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 8, 1937.

To Dr. Currie

From Chairman Eccles

Subject: Letter and memorandum from Mr. A. J. Altmeyer, Social Security Board.

I am handing you herewith a letter which I just received from Mr. A. J. Altmeyer of the Social Security Board, together with a condensed statement which he has written concerning the old-age benefits plan incorporated in the Social Security Act. I would appreciate your going over this memorandum and returning it to me together with your analysis of his statement.

MSE

Attachment.

SOCIAL SECURITY BOARD
WASHINGTON, D. C.

JOHN G. WINANT, CHAIRMAN
ARTHUR J. ALTMEYER
VINCENT M. MILES

January 26, 1937.

Hon. M. S. Eccles,
Chairman,
Board of Governors,
Federal Reserve System,
Washington, D. C.

Dear Mr. Eccles:

Mr. Winant was kind enough to let me read your memorandum concerning the old-age benefits plan incorporated in the Social Security Act.

The other day I tried to see how condensed a statement could be made relative to the reserve, eliminating philosophy, argument and discussion of ultimate effects. The enclosed memorandum is the result. I thought it might be of interest to you.

Sincerely yours,

A. J. Altmeyer

Enclosure.

FACTORS ENTERING INTO CONSIDERATION OF THE PROBLEM OF THE OLD-AGE RESERVE

1. Under any old age retirement plan like the one established by the Social Security Act, unless some money is collected during the early years, over and above the amount payable in benefits each year, the eventual rate of contribution will have to be almost double if the system is to be self-sustaining. This is because the number drawing pensions will increase each year for the first 30 years. Moreover, under an old age retirement system providing pensions bearing some proportion to past contributions or past earnings the average pension payable to those retiring in successive years will increase each year for the first 40 years. Thus, under the present federal old-age benefits plan, the total benefits payable each year increases year by year until in 1980 the total is estimated to be $3,000,000,000.

2. The government would have to collect a total of about 5% on the payroll from the very beginning, if it wished to fix a rate that would not need to be increased in the future and would still make the system self-sustaining. Under the present plan this rate is not reached until 1946. This means that from 1937 to 1946 the accruing liability for the payment of future pensions exceeds the amount collected. It is estimated that during the first year of operation alone this accruing liability will amount to $5,000,000,000 although only $600,000,000 will be collected in taxes. By 1946, the total accrued liability will be $25,000,000,000 and the total net collections (i.e. less administrative expenses and benefit payments) with interest at 3%, compounded annually, will amount to only $9,000,000,000.

3. The present scale of contributions provides a reserve just sufficient so that the interest on which at 3%, when added to current contributions, will always be sufficient to cover current benefit payments. However, the eventual maximum reserve is still only two-thirds of that which would be required to cover all accrued liability, i.e. two-thirds of the full reserve which a private insurance company would have to build up. A smaller reserve would not be sufficient to yield enough interest which when added to current tax collections would cover current benefit payments. Therefore, eventually contribution rates would have to be increased to a higher rate than the 6% maximum now provided, or benefit rates would have to be decreased, if the system is to continue to be self-sustaining.

4. The maximum reserve will be reached in 1980 after which time it will remain stationary. It will amount to $47,000,000,000. However, only $14,000,000,000 of this represents the excess of cash collections over cash payments, the balance of $33,000,000,000 representing compound interest.

5. If the interest on the excess cash collections were compounded at 2-1/2% which is about the present average rate instead of 3% as provided in the law, the amount of compound interest would be $25,000,000,000 instead of $33,000,000,000. The difference of $8,000,000,000 would represent a government subsidy.

6. If only the excess cash collections (not counting compound interest) were used to purchase outstanding government obligations and the outstanding government debt reached a peak of $35,000,000,000 this next fiscal year the final result in 1980 would be an outstanding government debt of $21,000,000,000 and government obligations held by the old-age reserve account of $47,000,000,000.

7. From the standpoint of the old-age reserve account the government obligations represent assets. From the standpoint of the government itself these obligations represent liabilities. From the standpoint of both they represent what has been termed a "bookkeeping entry". However, the importance of the bookkeeping entry is that it is recognition of the accrued liability which has been incurred.

8. Regardless of whether only enough is collected each year to cover the benefits payable each year or whether a reserve is built up, the benefits will always have to be paid out of the current national income. In considering the effect on mass purchasing power, the following factors should be taken into account:

(a) All governmental expenditures which affect mass purchasing power (such as Works Progress Administration and Resettlement Administration);
(b) The character of the general tax structure;
(c) The fact that the interest charge on the reserve, amounting to $33,000,000,000, must be met from general taxes.

9. Many of the European countries specifically provide in their social insurance laws that reserve funds shall be used to finance social programs benefitting the groups covered by the social insurance. Thus, in Czechoslavakia, France and Germany these funds have been used to finance low-cost housing programs and other social services such as the building of sanitaria.

10. It is likely that there will be a movement to start payment of benefits earlier and in larger amounts than now provided. Likewise it is probable and desirable that benefits be provided for permanent invalidity and for survivors. If survivors' benefits include benefits to orphans the increased cost would be considerable.

11. Since the present system is self-sustaining, reducing the rates of contribution or increasing the rates of benefits will require governmental subsidy eventually. Therefore, the fundamental question always to be decided is whether the recipients of pensions and their employers will be required to pay the full cost or whether the government will subsidize the system and if so when, how much, and in what manner.

February 8, 1937.

Dear Mr. Altmeyer:

I appreciate your thoughtfulness in sending me a copy of your condensed statement relative to the old-age benefits plan incorporated in the Social Security Act. Due to pressing matters here, I have not had an opportunity to give the study and thought to your memorandum which I desire to. I am submitting it to our Division of Research and Statistics for their comments.

Sincerely yours,

Mr. Arthur J. Altmeyer,
Social Security Board,
Washington, D. C.

MSE:VE:b

Form F. R. 131

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date February 25, 1937.

To Chairman Eccles

From Lauchlin Currie,
Arthur Hersey

LBC. ABH

Subject: Analysis of Mr. Altmeyer's statement on factors entering into consideration of the problem of the old-age reserve.

It is difficult to comment on this statement, as it is in the form of a series of factual points with no explicit conclusions being drawn. It is necessary to read between the lines and attempt to arrive at the implications in this way. I think it is safe to say that the facts selected and the emphasis indicate that Mr. Altmeyer is opposed to any lowering of the scale of contributions and that he would prefer to run a budgetary deficit as a means of avoiding excessive debt retirement rather than reduce contributions.

The implication of the first few points is that the contributions are not really high enough now to make the system self-sustaining. In support of this contention he adduces two considerations. One is irrelevant and the other is unimportant.

In the first place, he points out in effect that the scale of contributions is not high enough to build up a fund which -- at any time, at least within several decades -- together with compound interest and further contributions from the persons then on the rolls would be sufficient to meet accruing benefits for those persons if no new taxpayers were thereafter to be added to the rolls. It is, however, not necessary for the reserve fund under a compulsory plan ever to reach the full amount of the fund's "accrued liability" in order to make the plan self-supporting. All that is required for this purpose is that a sufficient fund be built up so that the compulsory and ascertainable contributions in perpetuity will continue to maintain the fund at a constant figure. This the present scale of contributions is designed to accomplish.

The second consideration is that the Government is obligated to pay 3 percent whereas it could possibly maintain its outstanding debt at $2\frac{1}{2}$ percent. This may be true but the annual subsidy on this score will be comparatively small.

Point 6 would appear to indicate that Mr. Altmeyer feels (a) that only the excess of contributions over benefits (not counting compound interest) might be used to retire debt and that (b) this would result in a final retirement of the publicly-held debt of only $14 billion.

If only the excess of actual cash collections over benefits were used to retire publicly-held debt, Congress would be in the position of appropriating money every year as interest on the fund and making no provision until 1967 for raising it from general taxes. (From 1967 to 1980 partial provision would have to be made to raise interest requirements from general taxation in order to meet an excess of benefits over current contributions.) In other words, a continuing budget deficit would have to be incurred. (This is obvious, for to the extent that Government debt in the reserve fund is increased without reducing publicly-held debt, there has been an increase in the total Government debt, i. e., deficits.) Thus, by virtue of the old-age security program so carried out, income taxes, etc., would be lower than they otherwise would be.

If income taxes, etc., are not lowered the alternative to debt reduction would be higher expenditures in other directions. The fact that Mr. Altmeyer points out (9) that reserve funds are used in certain European countries to finance low-cost housing, etc., may mean that he has this possibility in mind. It would appear, however, both economically and socially desirable that additional expenditures of the Government be financed on the principle of ability to pay and not out of taxes on the lower income groups. In any case both these possibilities imply a continuing deficit. If the budget is kept in balance by the imposition of taxes to cover interest paid to the fund, this interest would have to be used for the retirement of the publicly-held debt.

Mr. Altmeyer is in error in computing that the use of excess cash collections to retire outstanding publicly-held debt would reduce the amount of the latter only by $14 billion. It is true that interest credits total $33 billion and that the difference between $47 billion, the total fund in 1980, and $33 billion is $14 billion. The fact is, however, that up to 1967 excess cash collections will total approximately $23 billion. In subsequent years benefits will exceed net collections so that by 1980 the final net excess of cash collections will have been reduced to $14 billion. The larger figure is the one that would actually measure a reduction in outstanding debt publicly held under a policy of using excess cash collections for that purpose in each year in which they existed.

Finally, it may be pointed out that abstaining from making retirements of the publicly-held debt equal to the annual interest credits would not greatly affect the situation in earlier years. Debt retirements made between 1944 and 1953 would average $1.2 billion annually instead of $1.5 billion.

Point 8, on the effect on mass purchasing power, is particularly obscure. It would appear that Mr. Altmeyer has not grasped the difference between decreasing consumer buying power and decreasing savings. He observes that the interest on the fund comes out of general tax revenues. I am not sure that the implication of this is that such interest credits do not decrease consumer buying, but I have been given to understand that this may be his view. I am, therefore, attaching a brief discussion of this point. I did not include this discussion in my original memorandum since I was afraid it would be too technical.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

Social Security

not sent

February 25, 1937.

Mr. Arthur J. Altmeyer,
Chairman, Social Security Board,
Washington, D. C.

Dear Mr. Altmeyer:

May I convey to you my warmest congratulations on your appointment as Chairman of the Social Security Board. I am keenly interested in the business stability aspects of the social security program and if I can be of any service to you in this connection I hope you will not hesitate to call on me.

I received some comments on the recent memorandum you sent me and I have gone over it myself. I agree completely with you that the fundamental question always to be decided is whether the recipients of pensions and their employers will be required to pay the full cost or whether the Government will subsidize the system and, if so, when, how much, and in what manner.

I have come to the conclusion that while it is doubtless desirable to retain the contributory feature, we should abandon the attempt to make the plan as a whole self-supporting. I would favor lowering the maximum rate of taxes and postponing to a later date the application of the maximum rate. This, of course, would call for a subsidy from the Government after a period of years.

Although I am impressed by the social arguments for such a course, I am chiefly influenced by considerations relating to the conditions for long-term stability. It seems to me that the distribution of income is such that we are threatened with a semi-permanent deficiency of consumer buying power to maintain full employment. The present scale of contributions and benefits, by resulting in a net increase in savings, tends to aggravate this deficiency. The diminution of consumer buying arises not only from the excess of contributions over benefits but also, as is argued in the accompanying memorandum, from the excess of contributions <u>plus interest</u> over benefits.

Some of the points in your memorandum suggest that the possible embarrassment resulting from the operation of the present plan might be avoided by applying only the excess of actual cash collections to the retirement of publicly-held debt. It is pointed out that by 1980 the excess would amount to only $14 billion. I am wondering, however, if this is a relevant date and amount. Might not you arrive at a larger figure of retirements if you took an earlier year such as 1967?

I do not see how the retirement of publicly-held debt through the crediting of interest to the fund can be avoided unless we are prepared to run a continuing budgetary deficit, which appears to be undesirable on various counts.

May I again assure you of my continuing interest in this problem.

Yours very sincerely,

M. S. Eccles
Chairman