

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date January 4, 1939To Chairman EcclesSubject: Social SecurityFrom Lauchlin Currie
LC

Attached is a memorandum on the fiscal aspects of the social security program in 1940. There appears to be grave danger that the tax collections in the calendar year 1940 will exceed the probable benefits by nearly \$700 million. In addition, it is estimated that tax collections on unemployment compensation account will exceed benefits by about \$600 million.

SOCIAL SECURITY

1. Old Age Benefit Payments

The amount that will be paid out in old-age benefits in the year 1940 depends on the change in eligibility requirements adopted in the coming session of Congress. Considerable uncertainty seems to exist as to what changes will be recommended by the Social Security Board, and beyond that, of course, is the question of what the Administration and Congress will do with the Board's recommendations. A careful analysis of the various proposals being discussed at the present time suggests a treatment of benefits in terms of (a) the maximum probable and (b) the maximum possible payments.

(a) The maximum probable benefit payments in 1940

- (1) As the Act now stands, minimum earnings of \$500 are required in each year since the Act went into effect to qualify for benefits. It is suggested that this amount be reduced from \$500 to \$300.
- (2) The formula for calculating benefits will probably be changed from an accumulated earnings to an average rate of earnings basis. Supplementary benefits will be allowed dependent wives and children, partly at the expense of single men. The effect will be to raise the average monthly benefit payable from, roughly, \$15 to \$37.50.

- (3) Eligibility will be extended to include everyone in covered occupations with minimum required earnings who reached the age of 65 after January 1, 1937. It is still not entirely certain that this provision will be recommended by the Board. If it is not, however, and benefit payments are limited to those reaching the age of 65 in the year 1940 alone, the total amount paid out in 1940 will be insignificant.
- (4) Certain supplementary payments are being proposed. Disability benefits are the most important of these but also the least likely to be recommended by the Board in the immediate future.

If the rules concerning eligibility are liberalized in accordance with the above provision, it is probable that about 400,000 people will qualify for benefits. (The 400,000 figure is on a full year basis, allowing for the fact that those reaching the age of 65 in the year 1940 will, on the average, receive only half a year's payment.) At the rate of \$37.50 a month this would result in total benefit payments for the year of \$180 millions. In addition, some \$20 millions should be added for supplementary benefits, excluding disability, and another \$30 millions if the disability provision is adopted. Thus the total without disability would be \$200 millions and with disability \$230 millions.

(b) Maximum possible benefit payments in 1940

There has been some discussion of extending eligibility to include everyone over 65 with the required minimum earnings, in covered occupations in the last three years, whether or not he has ever come under the Social Security Act. That is, people who were over 65 on January 1, 1937, and hence were not registered under the Act, would be made eligible for benefits in addition to those who have been under the Act. If this were done benefit payments might conceivably reach \$500 millions. Such a move would involve considerable administrative difficulty since it would be necessary to secure data on the age and the earnings of people for whom no records have been kept. It would also involve a complete abandonment of the contributory principle, since not even one day's taxes have been paid by people in this category. From the point of view of increasing benefit payments in 1940 and the years immediately following, it would be very desirable, of course, to include these people. The important point to consider is, however, whether there is any actual chance of their being included. Will the Social Security Board really be so liberal in its benefit recommendations? And even if it is, will the Administration and, finally, Congress support such a recommendation? If it is in reality unlikely that the proposal will be adopted, its advancement at this time is liable to throw confusion into the whole debate. The effect is to make benefits look much larger than there is any chance of their actually being, and thus to support the position of those who urge an immediate increase in tax rates.

2. Tax Collections on Old Age Account

In estimating collections for the year 1940 it is necessary to take account of three factors: the proposed increase in tax rates; the size of payrolls in 1940; and the extension of coverage to include agricultural, domestic, non-profit, maritime, and bank employees. The increase in the combined tax (on employers and employees), if the present schedule is maintained, will be from 2 to 3 percent. Payrolls depend, of course, on the state of business activity, and if there is a new depression in 1940, all calculations will be upset. For present purposes, however, it is justifiable to assume that payrolls will be about the same as in 1937 (recognizing, of course, that decisions of fiscal policy will be an important determinant of what actually happens). In that year payroll tax yielded \$580 millions. With the same aggregate payrolls and a 50 percent higher tax rate, collections in 1940 will amount to some \$870 millions. Roughly, \$100 millions must be added to this if the proposed extension of coverage goes through. The total tax collections in 1940 would thus exceed \$900 millions.

It has already been pointed out above that \$230 millions is the maximum amount that can reasonably be expected in benefit payments in 1940. Extension of coverage will not affect the benefit figures until the new occupations have been under the scheme for three years. Thus, assuming the most liberal benefit provisions, which have any reasonable prospect of being adopted, there will probably be a \$750 million excess of tax receipts over benefit pay-

ments on old-age account alone. To this anticipated excess of tax collections on old-age account must be added any excess that may arise on unemployment compensation account.

3. Unemployment Compensation

During the calendar year 1940, with all the State unemployment compensation systems paying benefits, there will be a net withdrawal from purchasing power by the unemployment compensation system of about \$600 millions. State and Federal taxes levied in connection with the operations of the system will yield about \$1 billion and benefits paid to the unemployed and administrative expenses will amount to approximately \$400 millions. This compares with a net withdrawal during 1938 of \$450 millions, the result of taxes yielding \$900 millions and benefit payments and administrative expenses of \$450 millions. The withdrawal of \$600 millions during 1940 will be repeated in every moderately good year in the future.

4. Public Assistance Provisions of the Social Security Act

Attempts are sometimes made to minimize the deflationary effect of the payroll taxes just outlined by citing, as an offset against them, the amounts expended under the public assistance provisions of the Act. (Old-age pensions, dependent mothers' and childrens' benefits, aid to the blind, etc.) Such a comparison is, however, entirely inappropriate. The various assistance payments are really forms of relief and are more nearly comparable to WPA than to either old-age or unemployment insurance expenditures. They are, moreover,

supposed to be financed out of the general revenues of the Government. To treat them as an offset against payroll taxes is to imply acceptance of such taxes as a desirable instrument for financing relief and assistance payments. Such was certainly not the intention of the framers of the Social Security Act, nor are payroll taxes defended as a general financing instrument by any of the participants in current discussions of fiscal policy.

5. Summary

The fiscal effects of old-age and unemployment insurance in the year 1940 can be summarized as follows:

If the present tax schedule is adhered to, tax receipts will exceed maximum probable benefit payments by \$1,350 millions. If less liberal benefit provisions are adopted the excess may run as high as \$1,500 millions. It can thus be seen that for the next few years at least old-age and unemployment insurance schemes will operate as a great tax engine. Far from contributing anything to the consuming power of the public, they will withdraw income at the rate of a billion to a billion and a half a year.