

January 13, 1939.

CONTROVERSIAL ISSUES RAISED BY THE REPORT OF THE SOCIAL SECURITY BOARD

I believe that the Report of the Social Security Board contains in particular one recommendation which is of serious fiscal import and if adopted would impose a drag upon the recovery program and would be contrary to the broad policy underlying the Budget Message. The Board recommends that the payroll taxes as now provided in the act be increased on January 1, 1940, from two percent to three percent.

Even accepting the estimate of the Social Security Board with respect to the probable maximum benefit payments which may emerge from a Congressional enactment in response to its recommendations, it would still be true in my judgment that the payroll tax on an accrual basis in the calendar year 1940 would be likely to exceed the benefit payments by \$400 million. There appears, therefore, to be no need for stepping up the tax rates in January 1940. To do so would only add to a reserve which by January 1940 already will amount to \$1,700,000,000, or, in other words, to about three times the estimated maximum probable benefit payments.

I would call attention to the fact that in 1937 the collection of payroll taxes in excess of benefit payments was a major contributory factor in the decline in consumption that preceded the downturn in business. In the year 1938 the sums deducted from consumption and the stream of consumer purchasing power by the unemployment insurance taxes and the old age insurance taxes in excess of benefit payments amounted to about \$1,000,000,000. It appears that this huge sum acted in a powerfully deflationary manner. This sum amounts to a substantial proportion of the budget deficit of that year. Had this deduction from purchasing power not been made, the budget could have been much more nearly in balance. In 1939 the excess will again be about \$1,000,000,000 and will impose a drag on recovery. In the event that the tax rates are stepped up in 1940 this development will continue.

I believe that it would be extremely unfortunate at this time for you tacitly to approve the stepping up of these taxes before it is known what the scale of benefits will be as the result of amendments which Congress may make liberalizing benefit payments and extending coverage. After the benefit scale has been established there will be time enough to increase the tax rate in the event that benefit payments in fact prove to exceed current tax receipts. This is the more true in view of the fact that there will already be in the fund on January 1, 1940 a reserve of \$1,700,000,000, enough to provide for probable maximum benefit payments as estimated by the Board for almost three years.

Although I am not at this time making any recommendations relating to unemployment insurance, I think it pertinent, in connection with the proposed increase in the payroll tax rate for old age insurance, to point out that the excess of payroll taxes over benefits on unemployment insurance account will, in my judgment, amount to around half a billion dollars, assuming a national income in 1940 no higher than in 1937.

Endorsement of the Report in its present form, either implicitly or explicitly, would imply acceptance of a principle of financing old age insurance for which there is a rapidly decreasing expert and popular support. The accumulation of reserve funds is appropriate to private but not social insurance. This has long been recognized in other countries.

The only basis upon which the Social Security Board appears to justify the stepping up in taxes appears to be that the increase in taxes will help to educate the American employer and employees to the contributory system. I believe, however, that the contributory system itself has already been endangered by the imposing of taxes greatly in excess of the benefits being paid. I believe that the contributory system can be amply safeguarded by a declaration of Congress to the effect that as the cost of benefit payments increases in the future with an increasing number of eligible recipients, the increased cost load must be borne on a three-way basis by employers, employees, and the Federal Government, as is the case in England and other countries. In this manner the entire public will be made aware of the importance of keeping benefit payments within a proper bound so that the burden will not be unduly severe on each of these parties.

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extra*CONTROVERSIAL ISSUES RAISED BY THE REPORT OF THE SOCIAL SECURITY BOARDI - The Financing of Social Insurance

The collection of payroll taxes in excess of benefit payments imposes a serious drag on recovery. We are faced with a long term problem of deficient consumer buying power, - with an excess of savings over outlets for private capital expenditures. To continue a system which aggravates this deficiency intensifies our problem and postpones the day when it will be possible to balance the budget without interfering with business recovery.

The Report of the Social Security Board approves the imposition of a higher payroll tax rate in 1940 and hence envisages the further accumulation of a reserve fund, and the further net withdrawal of purchasing power.

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II - Deflationary Effects of Present System

In 1937 the excess of payroll tax collections over benefits was a major contributory factor in the decline in consumption that preceded the downturn in business.

In 1938, about \$1,000,000,000 had to be spent by the Government merely to offset the deflationary effects arising from the unemployment and old age insurance programs and in 1939 another \$1,000,000,000 will have to be spent for the same purpose. This has the effect of increasing the deficit without securing a corresponding increase in buying power.

In 1940 and thereafter, the increase in payroll tax collections arising from (a) increasing payrolls, (b) an extension of coverage, and (c) a fifty percent higher tax rate, may entail a repetition of the 1937 experience or the necessity of incurring a much larger deficit than would otherwise be necessary, unless the benefits are increased sufficiently to offset tax collections.

III - Recommendations

Since it is likely that tax accruals on old age account will exceed \$900 million in 1940 if tax rates are advanced as recommended in the report; since it is highly improbable in my judgment that liberalized

benefit provisions will result in a sum in the next year or two approaching this figure or even the figure of about \$600 million in taxes that would be collected if tax rates were not advanced; and since the reserve fund will amount to \$1,700,000,000 at the beginning of 1940, I feel strongly that it would be dangerous from a fiscal and monetary point of view if the scheduled increase in the payroll tax rate should go into effect on January 1, 1940.

Although I am not at this time making any recommendations relating to unemployment insurance, I think it pertinent, in connection with the proposed increase in the payroll tax rate for old age insurance, to point out that the excess of payroll taxes over benefits on unemployment insurance account will, in my judgment, amount to around half a billion dollars, assuming a national income in 1940 no higher than in 1937.

In view of the foregoing considerations, it would appear advisable to defer approval of the scheduled increase in the tax rate until it is known what the benefit payments adopted by Congress will amount to for the calendar year 1940.

If the tax rate increase is postponed at this time little difficulty in securing increases in payroll taxes in the future may be anticipated if such tax increases are actually necessary to finance current benefits and if, at the same time, a portion of the costs of such benefits is borne out of general taxation, as is the case in England and other countries.