

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

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To Chairman Eccles

Subject: Social Security Legislation

From Richard A. Musgrave R.A.M.

In response to your recent suggestion, we have gone into current proposals for broadening the social security system. I am attaching a summary statement and analysis of the various plans which has been prepared by Mr. Stettner.

Hearings on social security are now being held by the House Ways and Means Committee and by the Senate Committee on Education and Labor.

The Ways and Means Committee hearings are based on a report prepared by a special committee staff and are limited to topics discussed in the report. For this reason they will not cover the more ambitious programs, especially health insurance. On the points covered by the committee report, the staff experts are in general agreement with the proposals of the Social Security Board and the pertinent provisions of the Wagner-Murray-Dingell Bill. The hearings will deal primarily with certain improvements in present programs, including a broadening of coverage under the old-age insurance, some liberalization of benefits, and the introduction of permanent disability insurance. The committee probably will produce a bill recommending improvements along these lines, but it is unlikely that they will involve any considerable cost increases which would require an immediate step-up of pay roll tax rates. The extension of coverage under old-age insurance will pay for itself and disability benefits may be financed for the time being by drawing on the 7 billion dollars now accumulated in the old-age insurance trust fund. The present level of rates is considered adequate to finance the program probably for a decade, or if benefits are liberalized for at least 5 years.

The hearings in the Senate Education and Labor Committee deal with a health insurance plan, generally similar to the plan included in the Wagner-Murray-Dingell Bill of 1943, as well as in its later 1945 version. In terms of a pay roll tax, the cost of this plan would require something like a 3 point increase in present rates. This would raise the Federal pay roll tax (excluding the employer contribution to unemployment insurance) from its present level of 1 per cent to $2\frac{1}{2}$ per cent, payable by employers and employees each. There is some Administration pressure behind

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the health insurance program (witness President Truman's message of November 1945) and considerable popular support. However, the opposition (mainly the American Medical Association) is well organized and the outcome unpredictable.

The recent recommendations by the Social Security Board, the Wagner-Murray-Dingell Bill, and the House committee report, all imply a significant shift in attitude towards social security financing. There is increasing agreement that eventually a substantial part of the cost should be paid for out of general Treasury receipts, perhaps on the basis of a tripartite division between employers, employees, and Government. Also, there appears to be agreement that further additions to the social security fund should be avoided and the system be continued on a pay-as-you-go basis.

Attachment

OUTLOOK FOR SOCIAL SECURITY

By

Walter F. Stettner

Various proposals for a modification and expansion of the Social Security System are now before Congress. The most important are here discussed and summarized.

Present Status

The present social security legislation provides for a Federal system of old-age and survivors insurance, a Federal-State system of unemployment compensation, and for Federal grants to the States for assistance to certain needy groups.

The old-age insurance system (OASI) is financed by a pay roll tax on the first \$3,000 of wages in certain covered employments, payable at the rate of one per cent by employers and employees each. According to the revised Social Security Act of 1939, this rate was supposed to rise to 2 per cent in 1943 and reach 3 per cent in 1949. However, each year since 1942 the Congress has suspended the increase. Nevertheless, and due largely to the sharp increase in covered pay rolls during the war, the OASI Trust Fund has grown steadily and now exceeds 7.3 billion dollars, this sum being invested in Treasury securities of varying maturities. Benefit payments are running at an annual rate of 300 million dollars. The average monthly benefit level is \$24 for a single person, or \$44 for a worker and two children.

The coverage of the system is limited. The most important groups excluded are the agricultural workers, the self-employed, the domestic workers, employees of non-profit institutions, Federal, State and local employees, and railroad workers. In 1944, these excluded groups comprised approximately 21 million persons, or over two-fifths of civilian employment. Railroad workers, Federal employees, and a large proportion of State and local employees, however, are covered by separate retirement plans.

The unemployment compensation system is financed by a pay roll tax of 3 per cent payable by employers in covered occupations on the first \$3,000 of wages for each employee.

The tax is a Federal tax, but up to 90 per cent can be offset by State employment taxes, the remaining 10 per cent being used to finance administrative expenses of the State systems. As a result of experience rating systems provided for in most States, the average tax rate on employers in 1944 was 1.8 per cent rather than 2.7 per cent. The balances available to the States in the Unemployment Trust Fund are now 6.8 billion dollars as against 2.1 billion in 1941. ^{1/} Employers with less than 8 employees in industrial and commercial employment are excluded from the unemployment compensation system in many States, as well as most of the groups also excluded under the OASI.

The present Social Security Act further includes a number of Federal grants to the States for assistance payments of various kinds (including the needy aged, blind, and dependent children), which now amount to about 400 million dollars a year.

Current Proposals for Social Security Expansion

The more important proposals are contained in (1) the latest Annual Report of the Social Security Board, (2) the Social Security Amendments Act introduced in May 1945 (a revised version of the 1943 Wagner-Murray-Dingell Bill) and the related National Health Act introduced in November 1945, and (3) the recent report by the social security staff of the House Committee on Ways and Means.

Recommendations of the Social Security Board

The social Security Board has advocated at various times a comprehensive insurance system which would cover nearly all gainfully employed and include benefits for temporary and extended disability and health insurance provisions, as well as old-age and unemployment insurance. According to the Board's recommendation this comprehensive system would be placed on a national and federally controlled basis. In its Annual Report for 1943 the Board estimated that the probable entire cost of such a comprehensive system for the next decade could be covered by a 12 per cent pay roll tax. If we assume an average level of covered pay rolls of around 80 billion, this would imply a total cost in the neighborhood of 10 billion dollars. The Board visualized that eventually the cost would be borne by a three-way division between employers, employees, and the Government.

^{1/} The anticipated changes in the size of the Old-Age and Unemployment Trust Funds under present operations up to the middle of 1947 are shown in the latest Budget. The estimates indicate that a further increase of the OASI Trust Fund by about one billion dollars annually is expected for the immediate future. Deposits and withdrawals by States, from the Unemployment Trust Fund, over the same period, however, are expected to balance out.

No very recent estimates by the Board are available. However, the revised Wagner-Murray-Dingell Bill contains a downward revision of the pay roll tax to 8 per cent, and it may be assumed that the Board is not opposed to this change.

Until a comprehensive system is adopted, the Board recommends the improvement and broadening of the present system. Such recommendations are restated in the Annual Report for 1945.

(a) The main proposals with respect to old-age and survivors insurance are: the extension of coverage to all gainfully employed workers, the reduction of the qualifying age for women to 60 years, an increase in benefits particularly for low-paid workers, and an increase in the amount of annual earnings subject to the pay roll tax from \$3,000 to \$3,600. The Board recommends further that benefits equal to those for old-age retirement be paid to people suffering extended disability, and that credit be given to servicemen for their period of service.

To meet the cost of this broadened system of old-age insurance and disability, the Board recommends the enactment of a long-range financing plan looking toward an eventual tripartite division of cost. In a recent testimony, Chairman Altmeyer stated specifically that the present combined rate of 2 per cent would probably be sufficient to cover the current costs of the expanded OASI program for the next 5 years or more. An increase in the combined rate to 4 per cent would probably be sufficient to cover the current costs for 10 years or more. Also, the Board estimates that the cost of adding extended disability insurance to the present system would amount to a further 1 to 2 per cent of covered pay rolls after 15 or 20 years.

(b) With respect to unemployment insurance, the Board recommends inclusion of all employers of one or more in covered industries and the inclusion of workers in fields of employment not now covered wherever this is administratively feasible. The Board has also recommended uniform unemployment benefits to Federal workers during the reconversion period and the inclusion of seamen.

If the Federal-State system of unemployment insurance is continued, the Board recommends the substitution of a grant-in-aid system in place of the present credit-offset provision. A straight Federal tax, probably one per cent, would be levied in place of the present 3 per cent tax with the 90 per cent

credit-offset. This would raise Federal pay roll receipts, which would be applied toward Federal matching grants for both benefits and administration. Minimum benefit standards would be required as a condition for these grants. The Board also recommends the establishment of a permanent reinsurance fund to insure the adequacy of future funds.

As an expansion of the present system, the Board recommends the inclusion of cash benefits for temporary disability as part of the unemployment insurance system. Extended and permanent disability, as mentioned under (a), would be part of the OASI. This would involve an additional cost of approximately 1 per cent of pay rolls.

(c) The Board also recommends, without detail, the establishment of a national system of health insurance under Federal law with decentralized administration, but it has not advanced any detailed proposals. Again, however, it may be presumed that the Board is in support of the Health Insurance Bill discussed below. In addition to the social insurance provisions, the Board recommends a comprehensive Federal-State program of public assistance. Federal grants would be available to the States for payments to needy persons regardless of place of residence and to groups not now provided for by Federal grants. Matching grants to all States would be supplemented by variable grants which would take into account variations in State income and thereby remove present inequities. The Board further recommends the abolition of the present provision limiting matching grants for aid to dependent children to a certain benefit amount and proposes Federal financial participation in medical care payments for needy persons. The variable grant provision for public assistance would greatly improve the economic effects of the present system, because of the kind of taxes which the States impose for financing their relief expenditures.

The Wagner-Murray-Dingell Bill (S.1050)

The Wagner-Murray-Dingell Bill (originally introduced in 1943 and resubmitted in a revised form in 1945) would establish a unified and comprehensive insurance system, including health and disability insurance. There would be only one pay roll tax at a proposed rate of 8 per cent on the first \$3,600 of wages, divided equally between employers and employees. 2/
2/ In the earlier (1943) version of the Bill a pay roll tax of 12 per cent was proposed, similar to that suggested in the Social Security Board's 1943 report. The new version of the Bill provides for benefits somewhat larger than those suggested in 1943. The lower rate proposed reflects allowance for

A 5 per cent tax would be levied on the self-employed, who would be excluded from unemployment and temporary disability insurance. Pay roll tax receipts in a fairly prosperous early postwar year under this system might range from 6 to 8 billion dollars.

(a) The specific provisions under each type of insurance correspond on the whole to the recommendations of the Social Security Board. For the old-age, survivors, and extended disability insurance, the bill would reduce the eligible age of women to 60 years, would extend the coverage to all gainfully employed, and would increase the minimum and the primary benefits.

(b) The bill establishes a Federal system of unemployment and temporary disability insurance with extended coverage. For both unemployment and disability, the basic weekly benefit would range from 5 to 20 dollars (excluding dependents' allowances), the waiting period would be reduced to one week and benefits would be paid up to 26 weeks a year. In addition to the maximum duration of disability benefits, the bill provides for the payment of weekly maternity benefits up to 12 weeks to each woman eligible for disability. The provisions under this section would be administered by the Social Security Board.

(c) The health insurance section of the bill provides for medical, dental, hospitalization, and home nursing benefits to insured individuals and their dependents. The program would be under the supervision of the Surgeon General with a "National Advisory Medical Policy Council" advising him on questions of broad policy and administration. In administering this section, the facilities and services of State and local departments and agencies would be utilized where practicable. Three per cent of the wages collected under the unified contribution of 8 per cent would be allocated to a special account within the "National Social Insurance Trust Fund" called "Personal Health Service Account" from which all benefits would be paid. Expenditures for dental and home nursing benefits would be financed by appropriations from general funds allocated to this fund.

2/ (Footnote cont'd from page 4)

additions to the Unemployment Trust Fund since 1943. Also, it makes allowance for the Congressional desire--reflected in the freezing of OASI pay roll tax rates--to minimize further addition to the OASI Trust Fund. Accordingly, a government contribution to OASI at an early date, say after 5 or 10 years, may be expected under this bill. Also, some government contribution would be required to finance certain parts of the health insurance scheme (dental and home nursing benefits) which were not included in the 1943 version of the Bill.

These health insurance provisions of the Social Security Amendments Act have also been introduced by the same sponsors as a separate measure in the National Health Act. This bill was introduced on November 19, 1945 in response to President Truman's message outlining a comprehensive national health program. In addition to prepaid health service benefits, the bill contains the provisions of S.1050 concerning grants to States for public health services and maternal and child health services. Unlike S.1050--and for strategic reasons 3/--the Health Act contains no specific financing recommendations, but the wording suggests that the cost of physicians and hospitalization benefits could be covered by something like the 3 per cent pay roll tax as proposed in the more comprehensive bill. The cost of dental and home-nursing benefits would be financed from general appropriations.

(d) The Social Security Amendments Act also establishes a comprehensive Federal-State assistance program. It includes variable Federal grants to States for both payments to assistance recipients and administration varying with the per capita income of the State, and would eliminate citizenship and residence requirements as a condition for eligibility. The assistance system would be broadened to include all needy persons and Federal grants would be available for payments for medical services. In addition to the social insurance and public assistance provisions, the Act also proposes a national system of public employment offices and provides for grants and loans for hospital and health center construction.

The Report of the Ways and Means Committee Staff

This report was prepared in answer to a House Resolution adopted in March 1945 after the old-age insurance tax had been frozen for another year. The resolution authorized the committee to study the need for amending and expanding the Social Security Act with particular reference to old-age and survivors insurance.

The voluminous report was prepared under the direction of L. J. Calhoun, a former assistant general counsel to the Social Security Board. The report does not deal with the whole field of social security, since health insurance and temporary disability are not covered. (In view of this limitation, many of the recommendations are put forward without prejudice to what would be desirable if a more comprehensive system were established.) In general, the report is cautious in its recommendations and on many issues limits itself to an analysis of other proposals.

3/ Inclusion of financing provisions would have automatically referred the bill to the House Ways and Means Committee.

Old-Age and Survivors Insurance. The committee staff is most specific in its recommendations for revising the present old-age and survivors insurance system. It recommends an expansion of coverage to all groups now excluded and the lowering of the eligible age for women to 60 years. The report favors a liberalization of benefits, but on the whole is very cautious. The liberalization of benefits provided for in S.1050 is discussed but neither endorsed nor rejected. The report recommends the inclusion of benefits for extended disability as part of the OASI program and as a first step suggests that such insurance be applied first to the age group from 55 to 60.

On the question of financing the report agrees with the Social Security Board recommendations for an eventual tripartite division of the costs between employers, employees, and the Government. To achieve this goal, a modification of the present statutory provisions is recommended. In place of the increase provided for under present law, the report recommends that the pay roll tax rate be raised by one-half of one per cent every ten years starting in 1947 until 1977, when a 3 per cent level would be reached. After that time the rate should be revised upward or downward only if the anticipated Federal subsidy exceeds one-third of the total annual cost or the Trust Fund reaches some chosen total like 20 or 30 billion dollars. Since this recommendation does not deal with health insurance or the financing of temporary and extended disability insurance, it does not have to face the problem of an immediate increase in costs.

Unemployment Compensation. In general, the report appears to be in favor of maintaining the present Federal-State system, with an extension of coverage. It also recommends a modification of the present merit rating system.

On the subject of public assistance, the report favors the recommendations of the Social Security Board and the Wagner-Murray-Dingell Bill. It recommends the adoption of variable Federal grants for general relief, a program now entirely financed by the States and localities, and the introduction of variable grants for all public assistance programs. The report also favors the elimination of Federal maximum limits for assistance and the full Federal matching of medical care payments, as well as the elimination of residence requirements.

Summary Comparison

Despite substantial agreement there are also some significant differences between the three proposals. The most far-reaching proposals are those embodied in the Murray-Wagner-Dingell Bill which would establish immediately a comprehensive national system of social insurance, including health and disability insurance. It would also provide for an immediate increase in pay roll taxes from the present effective rate of approximately 4 to 8 per cent, applicable to the first \$3,600 of wage incomes.

The Social Security Board, though apparently in basic agreement with these proposals, seems to feel that the present time is not opportune for such sweeping changes, and accordingly has advanced proposals for more limited improvements. Though the Board also recommends the introduction of a national health and disability insurance system, its more detailed suggestions are directed toward improvements within the present framework of OASI and unemployment compensation systems. For the present, the Board has not recommended an increase of social security taxes.

The recommendations of the Ways and Means Committee staff are more limited than either of the other two. Health insurance and temporary disability are not considered and only minor adjustments in unemployment insurance are proposed. The staff report, however, is in substantial agreement with the other proposals regarding a broadening of the present Federal provisions on public assistance.

The widest area of agreement between the three proposals is on the subject of benefit provisions and coverage under the old-age and survivors insurance and on the inclusion of extended disability insurance under the OASI. All proposals, moreover, contemplate an eventual tripartite division of the costs, which indicates an important departure from traditional thinking on social security financing.

Current Developments and Prospects

On February 25, the House Ways and Means Committee opened hearings on Social Security Revision which are expected to be continued for several weeks. The hearings do not deal with any specific legislation but are intended primarily to be based upon the staff report to the Committee. The Wagner-Murray-Dingell Bill will be discussed only to the extent that its provisions deal with the topics discussed by the report. In the

Senate, the Committee on Education and Labor has started hearings on the National Health Act on April 2.

From the meager information which is available, it is difficult to venture a guess as to the probable outcome of the present Congressional action. The fact that immediate action in the Senate will be limited to a discussion of health insurance rather than the whole area covered by the Social Security Amendments Act would seem to indicate that the sponsors do not have much hope of passing the more comprehensive measure at the present time.^{1/} President Truman has indorsed the health insurance proposals. He has not as yet delivered a similar message indorsing the social security proposals of the Warner-Murray-Dingell Bill, although he has covered most of its aspects in his recent Budget Message and in earlier statements.

All public opinion polls point to a widespread popular support for some form of compulsory health insurance. However, there is also a formidable opposition led by the American Medical Association, and it is doubtful whether much progress will be made even on the subject of health insurance. If any action is forthcoming, it may take either the form of the National Health Act, or of grants-in-aid to State systems or of Federal support to voluntary systems.

The prospects of action on improvements in the old-age insurance system are somewhat brighter. It is likely that the coverage will be considerably extended, credit for military service given, and the eligibility age of women reduced to 60 years. Also the wage limit will probably be raised from \$3,000 to \$3,600, benefits will be somewhat liberalized, and permanent disability provisions may be included. Whether a change in the financing methods will be part of the revision is more problematic. There seems to be a strong feeling in the House for replacing the present system of freezing the tax annually by a longer-range policy. However, there is also strong opposition against raising the pay roll tax rates at the present time and emphasis is still on a pay-as-you-go plan. If a modification of present rates should be recommended, it may well be along the lines suggested by the Committee staff.

^{1/} It should, however, be mentioned that an Act dealing with Federal assistance for the construction of hospitals and health centers has recently been passed by the Senate and is now before the House.

Any substantial changes of the present unemployment compensation system beyond a possible extension of coverage to employers with one or more employees in industry and commerce are unlikely. Both with regard to unemployment compensation and the other aspects of the social insurance system, a great deal will depend upon the course of economic developments in the next few years and how Congress and the public at large appraise the outlook for the future.