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RESEARCH REPORTS

Summary

An analysis of the Social Security Act by the Institute's actuarial and research staff will be found in this bulletin. Although the passage of the measure was attended by little publicity, it is unusually important. In our opinion, it is dangerously unsound actuarially, and may create serious economic disturbances. However, we believe it to be unconstitutional, so it may meet death at the hands of the Supreme Court.

The Institute's Index of Industrial Production for July was slightly above that for June in spite of a sharp recession during the first week of the month. The Index of Inflation rose nearly two points, due chiefly to Government spending. The Commodity Price Index declined slightly.

The Social Security Act

The two major purposes of the Act are to provide funds for old age pensions and for unemployment benefits. Each of these will be discussed in turn. In addition, other titles of the Act provide for aid to the states for dependent children, maternal and child welfare, and public health work.

Provisions for Old Age Pensions

In order to obtain revenue for old age pensions, the Act imposes two kinds of taxes, an income tax on the wages received by employees, and an excise tax on all employers (with certain exceptions). Each of these taxes is a percentage of the wages not in excess of $3,000 paid during calendar years as indicated below:

Years	*Tax*
1937, 1938, 1939	1 %
1940, 1941, 1942	1½%
1943, 1944, 1945	2 %
1946, 1947, 1948	2½%
After 1948	3 %

Various classes are specifically exempted from these taxes, including agricultural labor, domestic service in a private home, casual labor not in the course of the employer's trade or business, service performed in the employ of governmental and municipal agencies, and employees of charitable or other non-commercial enterprises. It should be noted that the income and excise taxes are not imposed for the specific purpose of building up the Old Age Reserve Account which is created by the Social Security Act. Apparently, it was felt that constitutional difficulties prevented taxation for the purpose of providing old age benefits. The taxes imposed are termed "excise" and "income" taxes, and are not segregated in any way but are paid into the United States Treasury in the same manner as all other Federal taxes. Annual Congressional appropriations will be necessary to transfer these funds to the Old Age Reserve Account.

In Massachusetts there is a state gasoline tax which was imposed originally to pay for the construction and care of state highways. Despite the fact that this was the only purpose of the tax and that it is well adapted for this purpose, the tax has gradually been diverted to other uses. It should be noted that a fund established for old age pensions is peculiarly subject to abuse of this nature. Under the normal operation of the Old Age Reserve Account, it should grow rapidly during the first 20 to 40 years because a large volume of the contributions will be made by and for young employees who will not become entitled to benefits until after a long period of years. At first, therefore, the income of the fund should exceed expenditures. Undoubtedly, there will be political leaders who will ignore the fact that the excess of income over expenditures is offset by a growing liability in the form of an obligation to pay pensions in the future.

The Benefits

The old age benefits under the Social Security Act are payable to any individual who fulfills the following requirements:

1. He must be at least 65 years of age.
2. The total amount of wages paid to him in respect to employment after December 31, 1936, and before age 65 must be at least $2,000.
3. He must receive wages with respect to employment on some five days after December 31, 1936, and before age 65, each day being in a different calendar year.

Any person who qualifies for an old age pension under the above requirements will receive at age 65 a monthly pension which is equal to the sum of the following percentages of the wages which he receives after December 31, 1936, and before age 65:

1. One-half of 1% of the first $3,000 or less (if he has received $3,000 of wages, his pension will be $15 a month) plus.
2. One-twelfth of 1% of total taxable wages from $3,000 to $45,000 (if he has received $45,000 of wages his pension will equal $50 a month) plus.

3. One-twenty-fourth of 1% of total taxable wages in excess of $45,000. However, the total amount of the pension cannot exceed $85 a month (if he has received $129,000 wages, his pension will be $85 a month).

In addition, a death benefit equal to 3½% of the total wages received, minus any pension payments, is provided.

Possible Abuses

It is evident that these pension provisions may be seriously abused. For example, there are many individuals who are in business for themselves and who would not normally benefit from the operation of the Act. However, they could form a corporation to conduct their respective businesses and pay salaries to themselves, thereby becoming eligible for old age pensions. Several farmers aged 60 might form a "Farm Production Sales Corporation" for which they could work as salesmen. During the five years from age 60 to 65 each could pay himself a salary of $600 a year or a total of $3,000 in wages. Of this amount, 6% ($180) would have to be paid to the Federal Government in income and excise taxes. Each could then retire at the age of 65 and draw a pension of $15 a month or $180 a year for the rest of his life. This is probably the only scheme sponsored by any government which offers 100% annual yield. Of course, the cost will have to be borne by the great body of wage earners for whom the Social Security Act was originally intended.

Several large groups of the working population will contribute much less than the cost of their pensions. This is due to the fact that they will work only long enough to entitle them to a minimum pension of $10 a month. The worker who receives a pension of $15 a month, or less, will be obtaining a return of 100% annually on the taxes paid. The groups of which this is true are as follows:

A. There are many people who are unemployable in normal times. However, during the lifetime of any man who is normally unemployable, there will be a few great wars or periods of such "prosperity" as we had in 1929. At such times, even a person who is normally unemployable may find work and receive a minimum of $2,000 in wages which will entitle him to an old age pension under the terms of the Social Security Act.

B. There are also many farm laborers who work for a short time each year in factories, and who will receive just enough wages to entitle them to a minimum pension. There are probably many other groups of workers whose employment is ordinarily not included under the terms of the Act who will have, during their lifetimes, enough work which will come under the terms of the Act to entitle them to a minimum pension.

C. Another group which might cause substantial losses to the Old Age Reserve Account are those workers who will be only slightly less than 60 years of age on December 31, 1936. The value of the pension received by such workers will greatly exceed the taxes collected with respect to the employment of these men for the few years which remain before their retirement.

Because of the factors described above it is difficult to estimate whether or not the taxes imposed for the purposes of the Act will be sufficient. If losses are incurred because of the pensions paid to some groups, it is evident that other large groups have to pay more than the value of the pensions received by them. From studies made by the actuarial department of the Institute it seems probable that the taxes imposed under the old age section of the Social Security Act will be insufficient for the purposes of the Act. In this connection, it should be noted that the pension offered will serve as an inducement for men to qualify, who otherwise would not do so. For this reason, it is probable that the number who will qualify for the minimum pension of $10 to $15 a month will be much larger than was estimated.

In addition to the Federal old age pensions provided above, the Act also provides for aiding State old age pension plans. The Federal Government will pay one-half the old age pension (up to a total of $30 a month) paid under approved State plans. This is designed to aid those needy individuals who are too old to work, and who cannot benefit from the Federal pension plan because of their age.

Constitutionality of the Pension Provisions

The Tenth Amendment to the Constitution provides, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." On the whole, the powers of Congress have been clearly stated in the Constitution, and it is perfectly obvious that they do not include the power to establish any kind of a pension scheme unless that power is included in the following:

> "1. The Congress shall have power: to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States; . . ."

Presumably, the Supreme Court will be guided in its interpretation of this provision by the facts in the case to the extent that they are ascertainable, rather than by the avowed intent of the bill's originators or the apparent intent of Congress as evidenced by the language in the bill. In other words, the provisions of the bill must substantially promote the general welfare of the United States, or at least must tend to do so in the judgment of those eminently reasonable men, the Supreme Court justices.

It may at first seem that it is advantageous to provide a pension system for as much of the population as is practicable. There is a general disposition to assume that what is beneficial to a substantial portion of the population would be conducive to the "general welfare." However, there are sound reasons for believing that a pension scheme such as that proposed, with resultant removal of those over sixty-five from the wealth producing processes, might result in a substantially lessened production of wealth with a consequent reduction in the standard of living for the country as a whole. This would presumably not be conducive to the general welfare.

Many individuals more than sixty-five years of age, probably well over half of them, occupy positions suitable to their physical strength and mental capacities which enable them to participate in the wealth creating process. If these men and women were taken out of industry, out of such jobs as watchmen, caretakers, janitors, to mention a few, those positions would have to be filled by the younger men who in normal times would otherwise be far more effective factors in the production of goods and services.

There is also to be considered the fact that the taxes levied will reduce many incomes and at the same time increase the prices of necessities since there is no magic source of funds upon which employers can draw. The result must inevitably be a lower standard of living for a large portion of the population. Hundreds of thousands of employees in this country receive wages of from twelve to twenty dollars per week. To increase the cost of the necessities of life and at the same tax their salaries may do more harm to the general welfare than can be offset by a pension system. In our opinion, the bill is unconstitutional in this respect, especially since the benefits given to a portion of the population will be partly at the expense of others who cannot participate in future benefits.

Another constitutional question is raised by the provision that the income taxes specified are to be collected by employers. In effect, this would make every employer a tax collection agent for the Federal Government without compensating him for the time and effort involved in the process. In our opinion, this provision is likewise unconstitutional.

We do not believe that the Supreme Court will accept the fiction of an "Income Tax," as provided in this bill. The scheme is nothing more nor less than a compulsory old age pension plan applicable to a portion of the population. Attempting to disguise the payments to be made by calling them income taxes is one of the least subtle subterfuges used by the New Deal brain trust.

Probable Effects on Existing Private Pension Plans

Public pension plans will probably not be affected by the Social Security Act since employees of the National, State or Local Governments are excluded from the operation of the Act.

However, those private companies which now have their own pension plans are not exempt from collecting the income taxes and paying the excise taxes imposed for old age pensions. Most of the private plans, therefore, will probably be discontinued when the Social Security Act begins to function. In this connection, it should be noted that practically all private pension plans recently adopted have stipulated that the plan will be dropped if the employer has to pay State or National taxes for old age pensions. Even in those plans where this has not been specifically stated, it is probable that the same action will be taken.

Unemployment Insurance

In order to obtain revenue for unemployment benefits, the Social Security Act imposes on employers of eight or more persons an excise tax which is equal to the following percentages of the wages paid to employees.

Year	*Tax*
1936	1%
1937	2%
1938 and thereafter	3%

Various exemptions are made in the case of this tax also, the groups concerned being substantially identical with those exempted from the old age pension taxes. It should be noted that large firms will profit by subcontracting to smaller companies employing less than eight people and who will therefore not have to pay this tax. The employer may credit against 90% of his tax any contributions made by him to an unemployment fund under a state law with respect to employment during the taxable year.

It is impossible to analyze these various unemployment insurance plans from the point of view of actuarial soundness. Data regarding unemployment in this country are extremely limited, and it will probably be only after many years of trial and error that adequate data upon which to base unemployment insurance will have been collected.

Constitutionality

The constitutionality of the provisions for unemployment benefits may be questioned for somewhat different reasons than in the case of the old age pension scheme. The fact that the tax imposed applies only to employers of eight or more wage earners raises a doubt as to whether this violates the constitutional requirement that ". . . excises shall be uniform throughout the United States." Furthermore, a provision that employers in states having unemployment benefits may obtain a credit for 90% of the tax paid even more forcefully demonstrates the lack of uniformity throughout the United States so far as this tax on employers is concerned. There are no unemployment benefits payable by the United States from the funds received. It is perfectly obvious that this is not a tax in the ordinary usage of that word, but a coercive measure intended to force unemployment insurance on the several states. In our opinion this is unconstitutional.

In this connection, it may be added that the public welfare obviously requires care of the destitute, the sick who have no adequate means of support, and others incapable of caring for themselves. It has long been considered that the general welfare was best served when such individuals were given the necessary institutional or other care. It is a vast change, not yet provided for by the Constitution, to assume that it is the Government's responsibility to provide for the aged and the unemployed regardless of their actual needs and individual circumstances.

Social Security Board

In order to supervise the administration of the Social Security Act, a Social Security Board of three members is established.

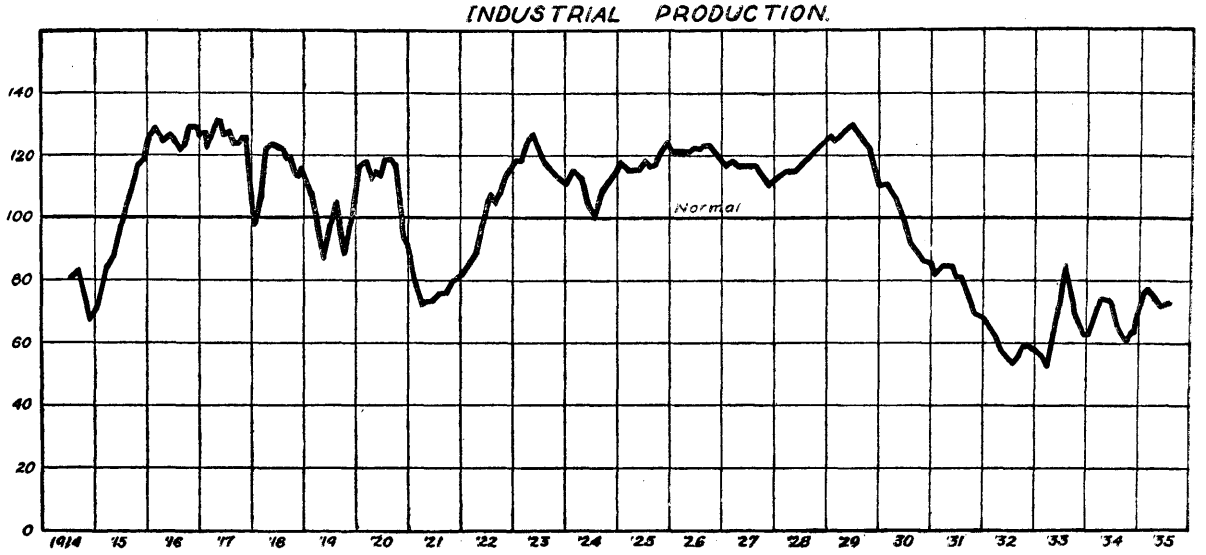
The Board is entrusted with the administration of the Act and is charged with the duty of studying and making recommendations as to the most effective methods of providing economic security through Social Insurance, and as to legislation in matters of administrative policy concerning old age pensions, unemployment compensation, accident compensation, and related subjects.

Other Provisions

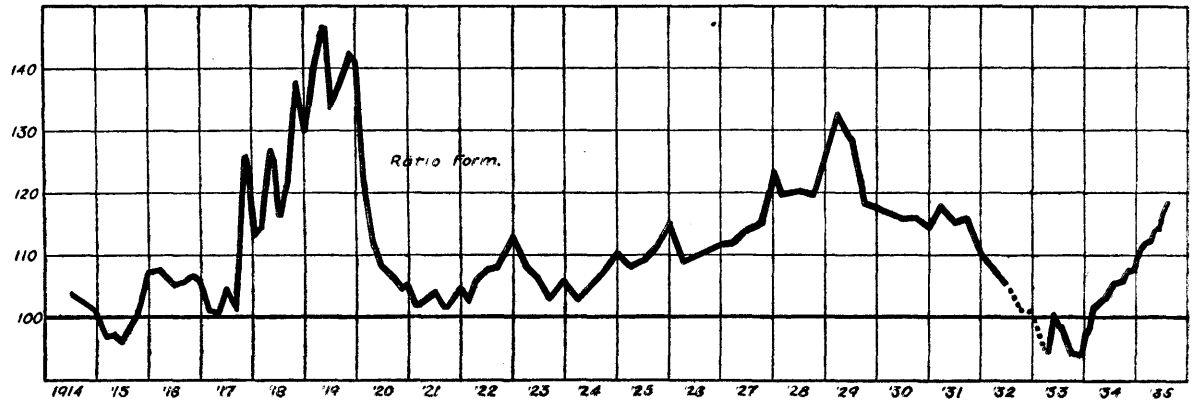
Included in the Act are provisions authorizing regular appropriations by Congress for the purpose of state aid to dependent children, for maternal and child welfare and the needy blind, and appropriations for assisting the states in public health work. The sums involved are relatively small. Annual appropriations authorized being, $24,750,000 for dependent children; $3,000,000 for the blind; $3,800,000 for maternal and child health services; and $8,000,000 for public health work.

Owing to lack of space in this issue the statistical summary of the three basic indexes will appear in the next weekly bulletin.

INDUSTRIAL PRODUCTION.



HARWOOD INDEX of INFLATION.



COMMODITY PRICES.