Social Security

I. Founding of Social Security / Public Pension Programs

A. Although poverty programs of various kinds extend well back into antiquity, the first nation-wide social security programs were begun in 1889 when Germany enacted an old-age social insurance program.

B. Other countries in Europe adopted similar programs over the next twenty years. For example, Great Britain adopted an Old-Age Pensions Act in 1908 and Sweden in 1913.

- **i.** (Other accident programs and health insurance programs were also adopted in Europe, and for public employees in various US cities and states.)

C. In 1909, the first old-age pension program legislation was introduced in the U. S. Congress.

- **i.** In 1915, Alaska adopted the first old-age pension that was not challenged on grounds of constitutionality. (Alaska was territory rather than a state at this time.)
- **ii.** In the US, the progressive movement attempted to pass various accident and health insurance programs at the state level, but most failed.
- **iii.** (In 1920, the American medial association declared its opposition to any compulsory medical insurance program.
- **iv.** State laws for workman's compensation were adopted in all states except 1929.)
- **v.** In 1930, California and Wyoming adopted Old-age pension laws.

D. On April 19, 1935, the social security bill (HR 7260) passes in the House 372 to 33 (25 not voting). On August 9, the bill clears the Senate and goes to the President for signing. On August 14, the President signs the bill, and social security becomes law.

- **i.** Conditions for qualifying for benefits:
  - a. beneficiaries have to be more than 65 years of age
  - b. wages > 0 earned in each of the five years before the age of 65 (totaling at least $2000).
  - c. Monthly benefits are 1/2% on the first $3000 of income, plus 1/12% of next $42,000, plus 1/24% on the remaining income.
  - d. (Note the declining replacement rates.)
- **ii.** Taxes are paid at the rate of 1% each by employees and employees, increasing to 3% each after 1950. [Note that these tax increases were reduced before they actually came to pass.]
- **iii.** (The social security act also includes provisions to encourage states to create unemployment insurance programs, through federal grants, partly funded by a 1% federal unemployment tax.)

E. Implementation of the Social Security Act

- **i.** On June 2, 1936 the social security account number was created by the Social Security Board.
- **ii.** (On August 17, 1936 an unemployed worker in Wisconsin received the first unemployment benefit under state law.)
- **iii.** On January 1, 1937, workers began to acquire credits toward old-age insurance benefits.
- **iv.** September 1937, the name Old Age Benefit Program was changed to the "Old Age Insurance Program." (OAI)
- **v.** (1939, Unemployment benefits became payable in 26 additional states bring the number of jurisdictions to 51 = 48 states + 2 territories + DC.)
- **vi.** 1939 survivors benefits added, the social security program becomes the Old Age and Survivors Insurance (OASI).
- **vii.** 1940, first person receives a monthly old age benefit check, $22.54.
- **viii.** In 1950 the social security tax was increased to 1.5% each for employees and employers.
- **ix.** 1955 Disability provisions are added (**Old Age, Survivors and Disability Insurance, OASDI**).
- **x.** The wage base of the social security tax is $4200.
- **xi.** (1956, first computer goes into service at the Social Security Administration.)
- **xii.** 1956, Social security benefits become payable for women at age 62.
- **xiii.** (During its first fifteen year period tax rates on eligible income rose from 1% to 2.25% each for employees and employers.)
- **xiv.** January 1957, tax rates increased to 2.25% for employees and employers. (The self employed pay 3.375%).

F. 1960 Medicare Emerges

- **i.** On June 30, the first bill to provide medical services for aged people not on public assistance but unable to meet their medical expenses was introduced in the Senate (S 3784).
- **ii.** September 1960, program of federal grants to states for vender medical care programs for aged people enacted. (Early form of Medicare.)

- **iii.** January 1966, States were authorized to set up medical assistance and medical assistance to the aged programs with the Federal Government to pay **50 to 80% of the costs**. (E.g. Medicare is initially done via matching grants.)
- **iv.** July 1, 1966, all persons over 65 were covered under the hospital insurance provisions of the new legislation. Benefits for the voluntary medical insurance program begins (for other medical expenses).
- **v.** (1967 the Freedom of Information Act became effective.)

II. General Features of the Public Pension Programs

A. Public pension programs have generally been a "pay as you go" system from its first days, with benefits paid from a flat tax on labor, "half" paid by labor and "half" by employers.

- **i.** (See the hand out and Social Security Administration website for the general increase in those taxes during the past fifty years.)
- **ii.** Of course the actual distribution of the burden of the social security varies with the slopes (elasticities) of the supply and demand curves for labor in the markets of interest.
- **iii.** Thus, in some markets all of the burden may be shifted to workers (employees), and in other labor markets the entire tax might be absorbed by firms.
- **iv.** (Use supply and demand curves to illustrate these possibilities, as well as intermediate ones where the burden is shared.)

B. The tax schedule for social security benefits is "digressive," a flat tax on the first B dollars of labor income, but zero taxes on income above B.

- **i.** (Show that this implies that the tax is proportional up to B dollars, but regressive thereafter.)

C. Benefits have principally been tied to age (65) since the programs beginning, and the benefit schedule has always been "progressive" in the sense that the replacement rate falls as income rises for recipients.

D. Analysis of Social Security using our tools:

- **i.** What level of benefits does the median voter desire?
- **ii.** How do the desired benefit level change as the median voter's age increases?
  - a. (They tend to increase because the present value of benefits increase while the present value of costs decrease.)
- **iii.** How do the median voter's desired benefit level change as the number retired persons increase?
  - a. (They tend to decrease because the discounted value of the marginal cost of those benefits increases. Higher taxes will have to be paid until retirement.)
- **iv.** How does the existence of a social security program affect employment levels?
- **v.** How does it affect decisions to retire?

III. Reforms of Public Pension Systems

A. The future imbalance between promised payments to retired folks and tax payments by those still working can be addressed in essentially three ways.

- **i.** Program benefits can be reduced: by reducing cash payments or delaying the age at which people qualify for the program.
  - a. Delaying retirement ages for healthy persons is probably the easiest method to solve the basic public pension problems.
  - b. However, this will be difficult unless the median voter accepts the necessity of such reforms.
  - c. In many countries this will require changes in manditory retirement laws.
- **ii.** Program funding can be increased:
  - a. Tax rates can be increased to generate more revenue.
  - b. (This has historically been the main solution, largely because the future taxed generation does not vote!.)
  - c. New debt can be issued to pay for the benefits, which implicitly increases future tax obligations
  - d. (To some extent this is already being done as deficits have been broadly increasing within most OECD countries, in part to meet the required health care and retirement benefits.)
- **iii.** Some other way of funding the future benefits may be attempted.
  - a. If the trust fund held stocks or non governmental bonds, it would have, in effect, "socialized" the stock market as the social security program would own a substantial fraction of the resources in that market.
  - b. The use of "forced" savings accounts has similar effects, but insofar as ownership remains private, this reduces the "socialization" effect, but may also reduce benefits because it transfer the financial risk to those with the accounts. (There would no longer be a government guaranteed future retirement payment.)
  - c. Many countries have experimented with "b," the partial privatization of social security--including Sweden.