

Social Security

Economics of Public Policy
PADM 625
Ben Muse

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Ida Fuller



- Miss Ida Fuller
- A retired legal secretary
- was the first social security recipient
- she supplemented the check with an apartment rental and stock income

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The first Social Security recipient

- Ida Fuller retired in November, 1939
- Received the first check in January, 1940
- She contributed \$22 in taxes from 1937 through 1939
- Her first check was for \$22.54

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The first Social Security recipient

- Ida Fuller died in December 1974
- She lived just over 100 years
- In that time she collected Social Security payments totaling \$20,944.42

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The origin of Social Security

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It all started with Bismark

- State run pension systems originated in Wilhemine Germany in 1889 at the instigation of Bismark
- Pay-as-you-go
- But retirement age was 70 and average life span was 48, so there were plenty of workers to support each retiree

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In the U.S...

- Social Security was introduced in 1935
- During the Roosevelt administration
- A response to the increasing life spans
- and the hardships of the depression

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A key question

- "Dole" or "insurance"?
- Should the program be a "dole"
- or should it be an "insurance" program?

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Committee on Economic Security

- Sub-cabinet group
- Headed by Secretary of Labor Frances Perkins
- Developed original proposal



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Roosevelt insists on:

- Wanted a system to which citizens contributed based on earnings
- definitely not a "dole"
- "citizens could take pride in collecting benefits they had purchased..."
- also insists on self-financing

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Two meanings of self-financing

- "pay-as-you-go" might mean taxes collected and earmarked for the program - taxes sufficient to cover the program's current expenses
- "pay-for-yourself" each generation pays for its own benefits

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In early debates

- "pay-as-you-go" and "pay-for-yourself" were seen as paralleling the "dole" and "insurance" distinction
- pay-as-you-go was similar to the dole
- pay-for-yourself was considered the insurance approach

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The committee was divided



- Secretary of the Treasury Henry Morgenthau, a member of the committee, argued for “pay-for-yourself”

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The committee was divided

- But under Perkins's leadership, the committee sent Roosevelt a recommendation for a program that more closely resembled “pay-as-you-go”

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Roosevelt, however...

- Opted for “pay-for-yourself”
- He told Perkins to modify the proposal because it was “the same old dole under another name”



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Social Security Act of 1935

- Congress passed the legislation submitted by Roosevelt
- the initial Social Security program was “pay-for-yourself”
- Tax collection started in 1937
- Benefits to start up in January, 1942

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The Supreme Court weighs in

- Could the U.S. create a mandatory old age insurance program?
- Tax could be imposed under taxing power of the federal government
- payments to elderly could be justified by power to promote the general welfare
- but they couldn't be linked

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Supreme Court

- Found program constitutional
- Evaluated all parts separately
- and approved
- but approved a program that was not the one that had figured in the debates and the public mind - a program in which taxes and payments were linked

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The Climate changes

- Supreme Court decision - ignores pension dimension, treats program as "pay-as-you-go"
- Political constituency developing
- Conservative concerns over size of the trust fund connected with a "pay-for-yourself" program

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Amendments of 1939

- Benefits expanded
- scheduled tax increases deferred
- benefits for wives, widows, dependent survivors
- Payments to be based on earnings, not contributions
- Move away from "pay-for-yourself" start paying benefits right away

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People continued to view it as an insurance program

- They thought they were putting their money into an account from which they would be paid in retirement
- but government maintained "accounts" to maintain illusion at great expense
- Luther Gulik protested to Roosevelt about the uselessness and expense of this "record keeping"

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Roosevelt:

- "Those taxes were never a problem of economics. They were politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits."

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Roosevelt:

- "Luther, your logic is correct, your facts are correct, but your conclusion's wrong. Now, I'll tell you why. That account is not useless. That account is not to determine how much should be paid out. That account is there so those sons of bitches up on the Hill can't ever abandon this system when I'm gone."

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And that's the way the program operates now

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FICA

- Federal Insurance Contributions Act (FICA) in 1999
- % of incomes up to a certain level
- 12.4% split equally between employees and employers funds Social Security
- 2.9% split equally funds Medicare, Part A

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Funded

- A generation contributes to a fund
- fund earns interest
- a generation begins to collect from the fund when it retires - not before

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Pay-as-you-go

- Collect taxes from the current working generation
- use them immediately to pay benefits to the current retired generation
- Same approach for each subsequent generation

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This works fine

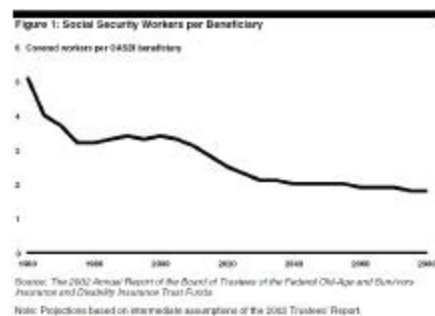
- As long as the working population is large in comparison with the retired population
- Or if the working population is growing
- and it grew with the baby boom and the entry of women into the work place

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But now

- The baby boom is getting older
- and living longer
- the ratio of workers to retirees is dropping and is expected to continue to drop

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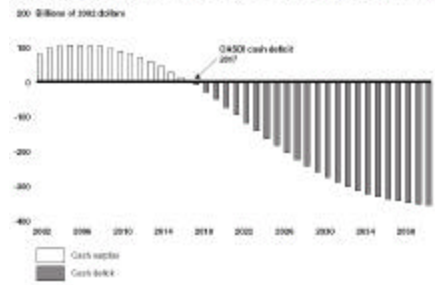
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1983 amendments

- Introduced gradual increase normal retirement age from 65 to 67
- increase early retirement penalty
- Introduced partial funding of the program
- As a result, program is currently building up some surplus in the trust fund

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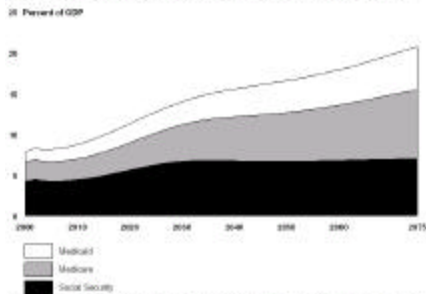
Figure 3: Social Security's Trust Funds Face Cash Deficits as Baby Boomers Retire



Source: GAO analysis of data from the Office of the Chief Actuary, Social Security Administration, based on the intermediate assumptions of the 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds.

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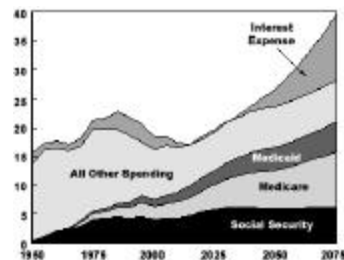
Figure 6: Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Source: Office of the Chief Actuary, Social Security Administration; Office of the Actuary, Centers for Medicare and Medicaid Services; and CBO. Note: Projections based on intermediate assumptions of the 2012 Trustees' Reports and CBO's June 2012 long-term projections under mid-range cost estimates.

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Federal Outlays by Category (as a % of GDP)



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Scrooge's question

- "Are these the shadows of the things that Will be, or are they shadows of things that May be, only."

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Economic Effects of Social Security

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Effects on retirement

- Income effect encourages people to consume more leisure (leisure is a normal good)
- Retirement payments also reduce the cost of leisure
- Net theoretical effect is to encourage people eligible for Social Security to retire earlier

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Effects on retirement

- Retirement hazard rate (percent of eligible workers who retire in a year)
- jumps at ages 62 and 65, key retirement ages
- Retirement hazard rate also appears to be related to Social Security wealth (present value of benefits)

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Effects on retirement

- So Social Security reduces work effort by persons 62 and older
- This increases costs of program
- and reduces the working force available to fund benefits

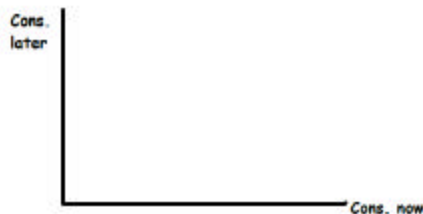
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Effects on savings

- There is an argument that a Social Security program will reduce savings

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Inter-temporal tradeoff



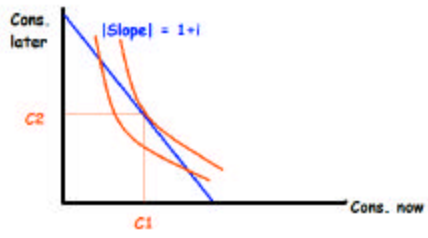
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Inter-temporal tradeoff



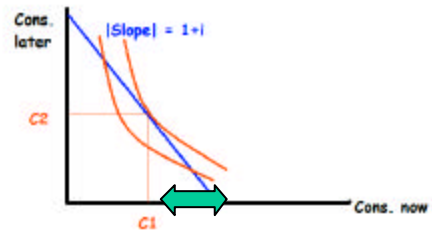
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Inter-temporal tradeoff



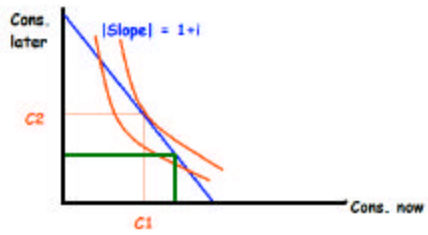
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Green arrow is "now" saving



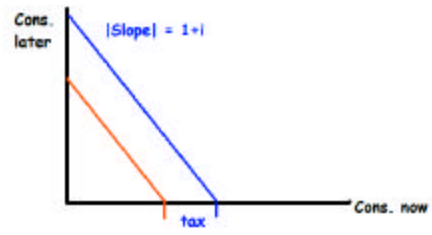
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Add tax now and payment later



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Tax shifts curve to left



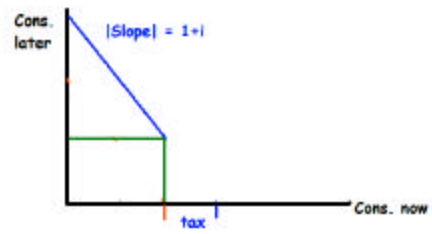
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Later payment shifts base of curve up



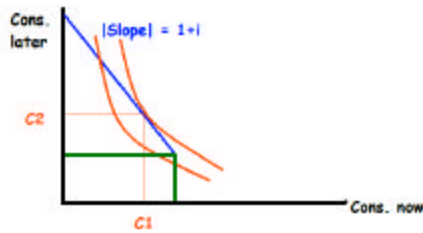
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Later payment shifts base of curve up



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Result, no change in now-later, less saving



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Effects on savings

- **Retirement effect** - if you want to retire earlier you may increase savings to do so comfortably
- **Bequest effect** - if parents think program had made them better off at expense of their children, they may increase savings to leave a bequest

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Empirical evidence

- Feldstein finds Social Security reduces savings, perhaps as much as 50% - other time series studies fail to find significant effect
- Panel studies tend to find an impact reducing savings by \$0.67 to \$1.00 for each dollar of Social Security "wealth"

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Significance of the issue

- Our ability to finance future Social Security (and Medicare) benefits
- will be enhanced by growing productivity of the economy
- this will, in turn, be enhanced by savings and capital accumulation
- negative impact on savings hurts

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Sources:

- Leonard, Herman B. *Checks Unbalanced. The Quiet Side of Public Spending*. Basic Books. 1986.
- 2003 OASDI Trustees Report. Accessed at <http://www.ssa.gov/OACT/TR/TR03/index.html> on Oct 22, 2003.
- Bruce, pages 255-279
- Ida Fuller portrait from the Social Security Administration's home page. Accessed at <http://www.ssa.gov/history/ssa/usa1964-1.html> on 10-28-03.

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