

by the earnings test is he denied benefits at age 65. Further, retirement benefits are not intended solely to guarantee a subsistence income to beneficiaries.

The welfare method has one great advantage over the universal demogrant: if the proportion of the aged requiring government help is small and if the administrative costs of determining need are not excessive, the objective of preventing destitution is accomplished at minimum expense by limiting payments to those with demonstrated need. Nonetheless, the welfare method has been rejected by most people because of two aspects.

First, a welfare program separates people into two groups—those who support themselves and those who require Government help.<sup>5</sup> The degree to which this distinction is degrading depends in large measure on the method by which eligibility for benefits is ascertained (i.e., the means test). When the test involves detailed probing, and frequently degrading investigations, the number of eligible persons who will even apply for benefits is severely limited; this is evident from the history of public assistance. On the other hand, eligibility for veterans' disability pensions is determined on the basis of a simple income affidavit, subject to sample audit, supplied annually by recipients. Neither a sense of alienation nor reticence to apply for benefits has been noted in this program.

Second, the welfare method may weaken individual incentives to save for retirement needs. Many persons would have a strong incentive to save less for retirement than they would if there were no Government program. They may safely enjoy maximum consumption in their youth, once they know that they can fall back on Government assistance when they retire. In addition, the fact that improvident individuals could finance retirement at public expense may discourage saving by people who otherwise would prefer to provide for their own retirement needs rather than depend on Government support. The importance of these perverse incentive effects depends critically on the implicit "tax rate" used under the guarantee. If benefits are reduced \$1 for each \$1 of investment income (that is, a 100 percent tax on investment income), the disincentive effects are bound to be far more severe than if benefits are reduced, say, 30 cents for each \$1 of investment income (that is, a 30 percent tax on investment income).<sup>6</sup>

The price of rejecting the welfare method of dealing with the aged poor is vastly higher expenditures to attain the same objectives. This price should be explicitly acknowledged as the cost of avoiding the humiliation of the means test and any discouragement of private savings that might occur. The historical development of old-age, survivors, and disability insurance (OASDI) and old-age assistance programs in the United States shows that our society has been willing to pay this cost.

Experience in the past with the means test under public assistance has resulted in an unfortunate emotional tendency in the community

<sup>5</sup> This point is developed fully by Robert M. Ball, "Social Insurance and the Right to Assistance," *Social Service Review*, vol. 21, No. 3 (September 1947), pp. 331-344.

<sup>6</sup> These aspects of social insurance are carefully discussed by Richard A. Musgrave, "The Role of Social Insurance in an Overall Program for Social Welfare," *The American System of Social Insurance, Its Philosophy, Import, and Future Development* (Princeton University, forthcoming).