SOURCES OF THE INSURANCE ANALOGY

Use of the insurance analogy to characterize social security in the United States has popular appeal because the nature of individual saving and private insurance is familiar and enjoys considerable respectability and even prestige. The flow of funds between the individual and the ultimate user of these funds is a vital part of a free market economy. Insurance companies are, furthermore, an important intermediary in this process; they channel the savings of many individuals to firms that wish to add to their productive capacity. The rates of return on individual savings reflect in large part the productivity of the physical capital they finance. There is, thus, a connection among the amount an individual saves, the value of his accumulated assets at retirement, the value of the annuity he can purchase with his previous savings, and the creation of additional physical capital and productive capacity in the economy. Provided the economy's resources are fully employed, these relationships are straightforward and are widely understood.

The vocabulary of the social security system helps to promote the insurance analogy. The very names—social insurance, old-age and survivors insurance, and disability insurance—suggest the analogy. Individual contributions (payroll taxes) are formally paid into trust funds. Benefits to retirees, survivors, and the disabled are formally based on preretirement earnings and are paid from the same trust fund accounts. Since interest is credited on trust fund balances, it is tempting to conclude that the trust funds are similar to the reserves of private insurance companies. Finally, statements by social security experts often tend to reinforce the parallel to private insurance. The following excerpt from a recent article by the Commissioner of Social Security is representative of many similar writings:

> The idea [of social security] is simply that while people work and are earning they contribute a part of their earnings to a fund, with contributions from the employer and now, in many countries, also from the Government. When earnings stop because one is too old to work or too disabled to work or because the wage earner in the family dies or because there is no job to be had or there are extra expenses connected with illness, for example, then the accumulated funds from all contributors are used to make up for the loss of income or to meet, in part or in whole, the expenses incurred. In return for setting aside some of the money one has when one is earning, the system provides an assured income when one is not.
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> Social insurance, like all insurance, averages out among all who are covered the risk that is too much for any one individual to bear.[15]

The following statement by Barbara Wootton expresses a very different view:

> As things are, everybody now recognizes an increasing element of fiction in current income schemes. As Americans have

[15] Robert M. Ball, "Policy Issues in Social Security," *Social Security Bulletin*, vol. 29, No. 6 (June 1966), pp. 3–4.