

COST-BENEFIT RATIOS UNDER THE FEDERAL OLD-AGE INSURANCE PROGRAM

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INTRODUCTION

What is the relationship between the value of accumulated old-age insurance taxes that persons pay into the OASDI trust fund and the retirement benefits that they can expect to receive on reaching age 65? If there were a close relationship between taxes paid in and the value of benefits received, the Federal old-age insurance program would conform to the popular conception of it as a kind of public insurance system. Workers covered by social security usually believe that they are paying for their future old-age benefits with the taxes they pay in during their working years. They conceive of themselves as purchasing an insurance policy, and for a person with the average life expectancy, the value of the taxes paid in would be similar to the value of the benefits received.

In keeping with this insurance conception of the program, social security benefits have often been referred to as annuities, and the tax payments have been called premiums. Originally, the Social Security Administration expected to accumulate a large trust fund. When the Federal old-age insurance program began, financing it by payroll taxes—even though they are regressive—was justified on the basis that it was an insurance system. Though the tax would be a much larger percentage of the income of the poor than of the rich, both would be paying for an annuity to be received during their old age. Such taxes would be in accordance with the benefit principle of taxation. Also, as an insurance program, no means test would be necessary to qualify for benefits on reaching age 65. Benefits were granted to all retired persons who qualified because it was believed that most would—more or less—have paid for their old-age pensions.¹

Early in its development, the Federal old-age insurance program departed in practice from this insurance concept. From 1937 to 1950, planned tax increases from the original 2 percent were continuously postponed. There have been eight amendments raising benefits, including the benefits of those already retired. "New start" provisions permitting persons to use high-income years and shorter periods as the basis for benefits, were adopted in 1939 and 1950. Coverage has been expanded several times to bring in additional beneficiaries who have contributed little to the fund. The 1965 amendment extends coverage to self-employed physicians and improves benefits for di-

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¹ In the 1935 act, refunds, including a payment to compensate for interest, were to be paid to persons whose tax contributions were too small to make them eligible for benefits and to estates of persons who had not received in benefits the amount they paid in.