

higher wage levels. This arises because OASDI is not an insurance system but a transfer payment system that distributes to the aged a share of the gains from the growth in the overall productivity of the economy.

The key distinction between the two approaches—private insurance and social security—turns on whether an individual currently in the labor force and paying taxes into the social security trust funds is paying for the benefits of current retired workers and survivors or for his own or his family's future benefits. In individual insurance, each person's premiums are contractually tied to his own and his family's future benefits. In social security, on the other hand, the level of payroll taxation is set to defray costs of benefits for the currently retired. The money which workers currently pay into the fund is not stored or invested but is paid concurrently as benefits to the various categories of current beneficiaries. Workers pay for benefits to eligible nonworkers. The future benefits of present workers, their dependents, or their dependent survivors will be paid in similar fashion out of the contributions of the working population as of some future date.

Thus, the analogy of an individual paying for his own insurance policy with contributions based on earnings is not applicable to social security. Unlike a private insurance firm OASDI does not have to accumulate large reserve funds to meet its future financial commitments. When benefits promised to current workers come due, the funds will be provided out of tax revenues as of that future date. The financial soundness of the social security program does not depend, as it does for a private insurance firm, on prudent financial management of present premium income but rather on the Government's effective power of taxation. The Government's ability to collect taxes sufficient to provide adequate social security benefit in the future depends critically on the maintenance of a sound Federal tax system in a healthy growing economy. The faster the rate of economic growth, other things equal, the lighter the burden of taxation that will be required to finance any given level of future social security benefits.

The practical importance of discarding the insurance analogy is not to discredit the concept of social security but rather to dispel basic misconceptions about certain aspects of the OASDI program. Once the insurance analogy is seen to be false, the social security contribution must be regarded as a tax, not an insurance premium, nor, indeed, as a contribution in the generally accepted sense. The financial interchange between generations does not depend on the existence of a particular tax—the payroll tax. It arises because each generation of workers undertakes to support the eligible nonworking population and implicitly expects similar treatment. In place of the insurance analogy, social security should be regarded as an institutionalized compact between the working and nonworking generations, a compact that is continually renewed and strengthened by every amendment to the original Social Security Act. When viewed in this light, a social security program has the eminently desirable function of forcing upon society an explicit decision at each point of time on the appropriate division of income and consumption between workers (the young) and nonworkers (the old survivors, and disabled). Workers and nonworkers alike participate in the democratic process that shapes this vital