Social Security

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Social Security Concepts

In the past half century, a vibrant new phrase has been introduced into our social and economic life—the magic words *social security*. Although the types of programs generally described as social security had been in existence in some countries for many years, until 1935 their development was quite slow in the United States. In that year, the Social Security Act was enacted and this alliterative phrase came into being. Since then many foreign countries, in developing new programs or in modifying old ones, have used this phrase in place of those used previously (such as national insurance or social insurance).

Quest for Security

The very nature of people is to strive continually for material security of all types for themselves and for their families, communities, and nations. But by human nature people are destined to have, at best, incomplete success in this quest.

From the first dawning of history, people faced serious physical dangers—from wild animals, from the cold, from famine and drought, and from their fellow beings. Over many centuries, the frequency and severity of these threats to physical security have been lessened, and in some instances virtually eliminated, as people have developed mentally and spiritually. Despite this, even today, in many countries of the world, most people have very little real security as to basic human needs for food, shelter, and medical care. In the economically more developed countries, material conditions are at a quite favorable level, so that most of the population, especially those in families containing workers, are reasonably well off, at least as long as the worker is employed.

This great improvement in the material well-being of the population in economically well-developed countries has, without exception, been the result of rapid industrialization and a change from a rural economy to a highly urbanized one. Formerly, families produced or bartered for most of their needs and had only a small supplementary cash income. Under the monetary economy resulting from industrialization, with its accompanying increasingly high standard of living, few people own any means of production, and many do not even own their own homes. Thus the loss of earning power to a family in an industrialized economy poses a problem completely in contrast to the situation in an agrarian economy. Although the industrial age has greatly aided people in their eternal quest for security by eliminating or diminishing many problems that have confronted them for centuries, certain new problems have arisen.

Methods of Attaining Security

In the earliest days of civilization, people attempted to achieve security completely by their own efforts. Soon, however, families banded together for both productive and protective efforts. This growth continued until there were villages, towns, cities, provinces, and nations.

In our industrial economy, the first method of attaining security of all kinds naturally devolves on the individual concerned. But this is only the beginning. Group action of all types is necessary. For physical security, we have the police forces, the military forces, the courts, and international agencies.

With reasonable assurance of physical security, there is still the problem of security against various risks of stoppage of earnings. Again, the primary responsibility rests with the individual, but our modern society and forms of government have prescribed certain responsibilities in this direction on the part of the employer and the government.

The individual's responsibility for providing his or her own economic security may be called "private individual provisions." Such individual provisions include savings, investments, homeownership, the so-called Keogh or H.R. 10 plans for self-employed persons (and their employees, if any), and the Individual Retirement Account and Section 401(k) plans (for employees whether or not under an employer-sponsored pension plan); the latter three involve special income-tax treatment.

Cooperative arrangements involving both the individual and his or her employer (or, under certain circumstances, groups of individuals) may be termed "group provisions." Such group provisions include private pension and other employee-benefit plans, deferred profit-sharing plans, and Employee Stock Ownership Plans (which receive special income-tax treatment).

The combination of private individual provisions and group provisions may be termed "private-sector provisions." Finally, programs established by governments may be called "social security."

These diverse methods of providing economic security for the citizens of our country have often been likened to a three-legged stool—supported by individual efforts, group efforts, and government programs. Another analogy is to denote the three legs as private efforts, social insurance, and social (or public) assistance (the latter two terms are defined in the next section). Perhaps a better classification, involving a more stable four-legged stool, would be as follows: private individual efforts, private group efforts, social insurance, and social assistance (with the last being the residual or final resort).

Concept of Social Security

The phrase *social security,* when considered in its basic composition, is so broad as to be virtually meaningless. The "security of the whole society" would encompass all activities of humankind—not only physical and mental, but even spiritual. As *social security* is commonly used, however, it connotes measures for economic security under government auspices.

Perhaps the first notable use of the term *social security* was by the great South American liberator, Simón Bolívar. In a speech given before the Congress of Angostura on February 15, 1819, he said:

> The most perfect system of government is that which produces the most happiness possible, the most social security (seguridad social), and the most political stability.[1]

The first use of the term "social security" in the United States was by Abraham Epstein, a long-time advocate of social legislation. In 1933, he changed the name of his organization, the American Association for Old Age Security, to the American Association for Social Security (see *Social Security Bulletin,* Spring 1992, p. 63).

Some individuals hold a very broad concept of social security, considering it to include such diverse programs as public education, vacations with pay, community organization and planning, counseling services, school lunch programs, research in health problems, and so

1. R. Blanco Fombona, *Simón Bolívar—Compiled Speeches and Proclamations, Notations, Prologues, and Publications* (Paris: Editorial House Garnier Brothers, 1913), 49.

forth. Generally, however, social security is defined as including a more restrictive scope of programs, namely (1) those providing cash payments to persons and families whose income from earnings has ceased or diminished, either temporarily or permanently; (2) those furnishing medical care to persons and families receiving benefits under item 1 or, under certain circumstances, to all persons of a given category; and (3) those providing cash payments with respect to all children of a given category, regardless of the presence or absence of parents who could support such children and regardless of whether such support is being given or in what quantity.

In this country, the term *social security* is widely, though not entirely correctly, used to refer only to the cash benefits provided by the Old-Age, Survivors, and Disability Insurance system (often called OASDI for short). Some usage, however, relates to both OASDI and the health benefits provided by the Medicare program (also established by the Social Security Act) in combination.

Types of Social Security Programs

Many different types of programs can fall within the more restrictive definition of social security. It may be said, however, that there are really only nine distinct branches or types of programs—as set forth in the International Labor Organization's Convention No. 102, "Minimum Standards of Social Security."[2] These may be classified as either short-term or long-term risks, depending on the length of time during which payments may be made to individuals.

Three branches involve entirely long-term risks—namely, old-age benefits, survivor benefits, and disability benefits. Old-age benefits are payable for life after the attainment of a certain age, often with certain requirements as to retirement. Survivor benefits are payable after the death of the breadwinner, either for life or for a period of years. Disability benefits, sometimes known as invalidity benefits, are generally payable during the continuance of permanent and total disablement. In the subsequent chapters, these three branches are treated simultaneously, since social security systems for one of these branches usually include one or both of the other two. A fourth branch, family allowances, is to some extent a long-term risk, since payments are made during the years when young children are present in the family.

The branches covering primarily short-term risks are unemploy-

2. For details on this convention, see Robert J. Myers, "New International Convention on Social Security," *Social Security Bulletin*, October 1951.

ment benefits, sickness benefits, medical care, and maternity benefits. The first two may, but usually do not, provide for payments over an extended period. Unemployment benefits are usually paid after a short waiting period and for a limited number of weeks in the event of the wage earner being out of work. Medical (or health) care benefits are either cash reimbursements or services granted in varying degrees and for varying periods of time to the individual, and sometimes to the family, in the event of illness. Sickness benefits, sometimes referred to as temporary-disability benefits, are payable after a short waiting period for a limited time, with benefits under the disability branch entering in when the disablement becomes permanent (or lasts longer than benefits are payable under the sickness branch). Maternity benefits consist of both medical care and periodic cash payments; in reality, this branch is a combination of two branches, sickness benefits and medical care, so as to provide for the special risk of maternity.

The ninth branch, industrial-injury benefits, is a combination of short-term and long-term risks, because it includes sickness benefits, disability benefits, and medical care for the individual who is injured (or contracts a disease) at work, as well as survivor benefits for any dependents if death results from such causes.

Besides these nine branches, there can be broad general income-supplementation programs applicable to the entire population, generally on the basis of a means test. Such programs include guaranteed-annual-income plans, negative-income-tax plans, and food-stamp plans. They can properly be categorized as social security plans even though they do not fall specifically within any of the nine branches.

Social security programs can be subdivided according to their general nature as well as according to the particular risk with which they deal. Perhaps five broad categories may be distinguished—social insurance systems, social assistance systems, universal benefit (or demogrant) systems, mandatory employer plans, and subsidized voluntary insurance. In some instances, the classification is not clear-cut.

Generally speaking, social insurance systems involve definite benefit amounts and qualification conditions prescribed by law, with the cost being met by contributions from the covered individual and/or the employer and, sometimes, in part from general government funds. Social insurance programs are always administered by government organizations (on this point, however, note the subsequent discussion). Coverage of such programs is compulsory, with certain minor exceptions, and applies to workers of a considerable number of employers. Appendix A gives a definition of social insurance developed by the Commission on Insurance Terminology. The OASDI system and the Hospital Insurance portion of the Medicare program are examples of social insurance programs, as are the wage-related pension systems of Canada and many Latin American and European countries and the unemployment insurance systems of Canada and the United States.

Social assistance systems have considerably more discretionary features than social insurance systems, with the amounts of the payments based on individually determined need and financed from general government funds. In some instances, the "need" is determined arithmetically on the basis of a prescribed monetary standard as compared with the individual's (or family's) other income and assets. Just as in the case of social insurance programs, social assistance programs are always administered by government organizations. The several federal-state public assistance programs and the federally administered Supplemental Security Income program for the aged, blind, and disabled in the United States are examples of social assistance systems,[3] as are the similar programs in Canada and the national assistance program in Great Britain.

Universal benefit systems generally cover the entire population of a country, rather than merely the employed population, and they condition the payments (and their amounts) on demographic elements (for this reason, such programs have sometimes been termed *demogrant systems*) such as age, residence, and family status. Under some systems that involve the entire population of a nation, the benefits provided are flat amounts basically, but they involve an income and/or assets test that is mathematically administered; although this procedure is not a needs test on an individual basis, such a system nonetheless should properly be classified as a social assistance program rather than as a demogrant program. In certain instances, demogrant programs may be partially financed by direct earmarked contributions, such as a percentage of each resident's gross or net taxable income, but they are distinguished from social insurance systems because there is no relationship between benefit receipt and contribution payment. Universal benefit systems are always administered by government organizations. The Canadian Old Age Security program (flat benefits to persons aged 65 and over) is an example of a universal

3. In the first edition of this book Supplemental Security Income (SSI) was classified as a universal benefit system (because of its universal nature and flat-rate benefit amount standards), but on further consideration the reductions for other income and the assets tests seem to make classification as social assistance more logical.

benefit system, as are the similar programs of Australia (from age 70 on), New Zealand, and the Scandinavian countries.

Interesting examples of demogrant proposals are in operation in Alaska. Beginning in 1973, all persons aged 65 or over who had been residents before statehood (January 3, 1959) were paid $100 a month regardless of need, income, or assets. This was later increased to $250, and then extended to all residents of two years or more. Further, all residents regardless of age (including those aged 65 or over) receive an "annual dividend" payment, which was $953 in 1990. All of these payments are financed from the state's oil royalty and tax revenues.

More sweeping demogrant proposals have been made in the United States, but were not adopted. Among these were the Townsend plan (as discussed in Chapter 11) and similar ones put forward in the 1930s to provide flat periodic grants to all aged persons and the proposal by Senator George McGovern in his unsuccessful bid for the presidency in 1972 to give a flat $1,000 annual grant to all residents regardless of age.

The mandatory employer plans are those under which employers are required by law to establish certain types of benefits for their employees. These plans either are administered by the employer or are contracted-out with a private insuring organization—at times with the alternative possibility of using a competing government organization. In many respects, these plans are similar to social insurance systems—especially if the exact form and amounts of the benefits are prescribed by law—but the distinguishing characteristic of social insurance systems is the mandatory government administration. The original version of the Ontario Pension Benefits Act, which would have required certain employers to establish pension plans with certain benefit standards, was an example of a mandatory employer plan, but this provision was not contained in the final legislation; so also are the state workers' compensation systems in the United States (other than those that require the employers to purchase protection *only* from the "monopolistic" or "exclusive" state fund). Some authorities, however, would classify workers' compensation as social insurance, because the benefits are prescribed by law and the administration is performed either by a government agency or under the close supervision of such an agency. The proposal of the Nixon administration for national health insurance, as made in 1972–74, also took the mandatory employer approach.

Subsidized voluntary insurance plans are those under which the government encourages individuals to protect themselves against certain risks by subsidizing part of the cost for those who opt for coverage. Such programs can be administered by the government or by private organizations. The Supplementary Medical Insurance portion of Medicare is an example of a program of this type, as are the medical care programs in some European countries that are operated through mutual-benefit societies.

Individual Equity and Social Adequacy

Whenever a social security system involves contributions from the potential beneficiaries, the question of individual equity versus social adequacy arises. Individual equity means that the contributor receives benefit protection directly related (i.e., actuarially equivalent) to the amount of his or her contributions. Social adequacy means that the benefits paid will provide a certain standard of living for all contributors. The two concepts are thus generally in direct conflict, and social security systems usually have a benefit basis falling somewhere between complete individual equity and complete social adequacy. Usually the tendency is more toward social adequacy than toward individual equity. A classic and monumental discussion of this subject was presented by Reinhard A. Hohaus in 1938, and it still remains valid (see Appendix B).

Individual private insurance policies are, of course, necessarily based on the individual-equity concept. This does not mean that each individual will necessarily always get exactly his or her money back plus interest, as in the case of a savings-bank account or some government bonds. Rather, insurance company contracts have premium rates actuarially determined for the benefits provided, so that policyholders in the same risk class pay the same premium amount for the same benefit. Due to random chance, the relationship between premiums paid and benefits received under a private insurance company contract will vary considerably for a given selected group of presumably identical risks. But in advance, no one can foretell which of the group will die early and thus receive benefits far in excess of premiums, and which will die after many years of premium participation and thus receive benefits well below the premiums accumulated at interest.

The concept of social adequacy must, of necessity, play a large part in group plans and in social security systems. If too much individual equity were to prevail when a system was started, the benefits paid would be relatively small. Thus many years would elapse before the system would begin to meet the purposes for which it was established. Nonetheless, it is quite common to maintain a certain degree of individual equity in group plans and social security systems, although more stress is placed on social adequacy.

Somewhat related to the elements of individual equity and social adequacy is the matter of what might be termed group equity. From the standpoint of fair and equitable treatment, it seems highly desirable that in any social insurance or other social benefit program, persons with virtually identical circumstances should, as much as is feasible, receive the same benefits. In other words, there should be as few sharp borders as possible. For example, the benefit amounts should not differ greatly for persons with identical earnings records who reach the normal retirement date on December 31 of a particular year compared with those who do so on the next day. However, sharp borders cannot always be avoided, as, for example, in the case of persons who just miss acquiring the necessary coverage eligibility requirements.

Relative Cost of Social Security versus Private Insurance

Sometimes, statements are made that social security programs are much less expensive than private insurance (or else that they can provide more benefits for the same cost). At times, when considering the experience in the early years of operation of a long-term benefit program, this seems to be strikingly so. The explanation, however, is largely that for those initially granted benefits, the social-adequacy concept applies much more importantly than does the individual-equity concept.

One argument of those who state, or imply, that social security systems can do the job so cheaply is the application of the so-called magic of averages. Under this theory, presumably because social security systems are so large, with regard to the number of persons covered and the amount of contributions collected, relatively low benefit costs are inevitably expected to result. This belief is, of course, fallacious. It seems to be a direct parallel to the classic economic fable of the storekeepers who pay $1 a dozen for eggs and sell them for eight cents apiece, but claim that they can nevertheless make a profit if they sell enough.

Actually, a social security system is not a magical machine. A contribution or tax of $1 put into one end cannot result continuously in $10 of benefits at the other end. It is basic logic that the cost of a system is determined solely by the benefits and the administrative expenses paid. Accordingly, if in the aggregate the relative benefit cost of a social security system is the same as that of a private individual plan or a group insurance program, any difference in total cost can arise only from differences in administrative expenses. Generally, however, administrative expenses represent only a small fraction of benefit costs, so that any cost advantage that a social security system possesses because of its size must be relatively small. Large systems have one other advantage over smaller ones. Since accidental and random fluctuations of experience are likely to be relatively smaller in a large-coverage program, less need exists for providing margins for contingency reserves.

The real reason for having a social security system in addition to private insurance coverage is not primarily that of cost, but rather that social benefits on a social-adequacy basis can only in this way be provided to a large sector of the population.

Social Insurance as "Insurance"

At times, the issue has been raised whether it is really proper to use the word *insurance* in connection with social security or social insurance. It would seem that this use is justified because of the broad pooling mechanism utilized in social security systems, even though, from a strictly legalistic standpoint, proper usage of this word might also require that there be a lawful and binding contract. The OASDI-Medicare system does not involve any contractual arrangements, although the covered individual does have statutory rights to benefits that are legally enforceable. Specifically, *Webster's Ninth New Collegiate Dictionary* (Springfield, Mass.: Merriam-Webster, Inc., 1985) gives the following definition of "insurance":

> **1 a:** the business of insuring persons or property **b:** coverage by contract whereby one party undertakes to idemnify or guarantee another against loss by a specified contingency or peril **c:** the sum for which something is insured **2:** a means of guaranteeing protection or safety

Social insurance seems to qualify under item 1b of this definition, since indemnification against loss by a specified contingency is certainly done under such programs. For example, the "indemnification" is the benefits payable, the "loss" is the presumptive loss due to not being able to work, and the "contingency" is such things as old age and disability retirement. The fact that this protection must be furnished under a contract according to the definition does not preclude social insurance from being termed "insurance" on the grounds that it is not a "contract" enforceable by law. In fact, social insurance benefits are statutory rights, enforceable by law, and the term *contract* is actually defined broadly in the dictionary as being an agreement between parties to do something.

It is recognized that the use of the term *social insurance* may result in some misunderstanding of the basic nature of a social security program by the general public, who tend to think of it in terms of their acquaintance and knowledge of private insurance, or even government insurance involving a contractual relationship (such as the Servicemen's Group Life Insurance program for those in, or formerly in, military service; crop insurance; and parcel post insurance). Nonetheless, the term *social insurance* is very popular both here and abroad, and by usage and dictionary meaning seems proper.

The constitutionality of the old-age benefits program established by the Social Security Act was affirmed by the Supreme Court in 1937 (*Helvering v. Davis*, 301 U.S. 619). Immediately following this ruling, "insurance" terminology was introduced into the administrative operations of the program and into public information documents. This terminology had not been previously introduced because of the possibility that to do so would adversely affect the judicial consideration. (For the same reason, the benefit and tax provisions were in two separate titles of the Social Security Act and seemed to be independent of each other, although they frequently used identical language, such as what employment was not covered.) Then the 1939 Act was written with extensive use of "insurance" terminology, for example, the Old-Age Reserve Account was renamed the "Old-Age and Survivors Insurance Trust Fund."

There has been considerable public discussion to the effect that the Supreme Court has declared that the OASDI system is not "insurance." Statements of this kind are based on the decision in the *Nestor* case (*Fleming v. Nestor*, 363 U.S. 603, 1960), which dealt with the constitutionality of a provision prohibiting payment of OASDI benefits to persons who had been deported for subversive activities. Actually, the decision stated that "the Social Security system may be accurately described as a form of social insurance, enacted pursuant to Congress' power to spend money in aid of the general welfare." At the same time, the Supreme Court recognized that a covered employee has a noncontractual interest that "cannot be soundly analogized to that of the holder of an annuity, whose rights to benefits are bottomed on his contractual premium payments." In this respect, the government brief made a statement that has frequently been misunderstood—namely, that "the OASI program is in no sense a federally-administered 'insurance program' under which each worker pays 'premiums' over the years and acquires at retirement an indefeasible right." The foregoing statement must be viewed as a whole; because of the absence of a comma after "program," it does not state that OASI is not an insurance program of some other type than that described.

Furthermore, it should be noted that Congress has referred to OASDI benefits as "insurance benefits" and has designated the part of the Internal Revenue code that levies the employer and employee taxes to support the OASDI system as the "Federal Insurance Contributions Act."

Regardless of the conflict over the applicability of the term *insurance* to social insurance programs, it is clear that social insurance and private insurance (including government insurance plans on a contractual basis) have certain elements in common and also certain elements that are distinctly different. This is not to say that because of any such differences, one form is good and the other form is bad. Rather, both forms have important—and complementary—roles to play in the economic and social life of the nation.

Among the areas in which social insurance and private insurance are similar are the following: a widespread pooling of the risks against which protection is provided; specific, and generally complete, descriptions of all conditions pertaining to coverage, benefits, and financing; precise mathematical calculations of benefit eligibility and amounts; and specific tax, contribution, or premium rates which are computed to meet the estimated costs of the system. On the other hand, the areas in which social insurance and private insurance are, to some extent or other, dissimilar are the following:

1. Private insurance should be based on individual equity. Social insurance, although possibly having certain individual-equity features, must generally contain a considerable degree of emphasis on social-adequacy principles.
2. Private insurance is usually on a voluntary basis as to participation. Under some employee-benefit plans, the employee must participate, but the employer's action in establishing the plan is voluntary—even under collective bargaining. In some states, automobile insurance is compulsory, but with the insured usually having a choice of insurer. Social insurance almost invariably is based on compulsory participation.
3. Private insurance involves complete contractual rights between the two parties (the insurer always has the right to terminate the contract on nonpayment of premiums; however, usually, it must continue the contract in force for the period specified—but note

the cancelable type of health insurance and the variable-rate provisions in some noncancelable health insurance). Social insurance does not involve a strictly contractual relationship, although the benefits involve a statutory right (but the statutory provisions can be changed unilaterally by the government or other responsible authority).

4. Private individual insurance must be fully funded so that the rights of the insureds are protected, and this is a desirable goal of private pension plans. (But note that under such plans, full funding is often not present, especially with regard to prior-service benefits). Social insurance, because of its compulsory and statutory nature, need not be fully funded—in fact, it is generally thought that, from an economic standpoint, full funding is undesirable.

Originally, the criticism of the use of the term *insurance* came from persons associated with the private insurance business. Admittedly, the Social Security Board (now the Social Security Administration) very definitely overstressed the insurance concept in the early days of the program. This was done primarily to build up and maintain public support for the social security program—by drawing on the good name and reputation of private insurance.

More recently, some economists have attempted to discredit the insurance principle under OASDI.[4] Such economists seem to consider insurance as involving only individual policies, which, by their very nature, are founded on individual equity. They fail to consider the various group insurances, which have many of the same characteristics as social insurance. Under the group insurances, quite properly, employees do not usually share equally (or proportionately with salary) in the employer's contributions.

Social security is not completely analogous to private insurance, although certain characteristics are common to both. Despite what such economists assert, the cost of the OASDI program can be actuarially evaluated in a reasonably reliable manner, just as much as can group plans of a private nature, which are just as subject to future change. Again, benefits under OASDI are equally on a predetermined basis

4. For example, see Joseph A. Pechman, Henry J. Aaron, and Michael K. Taussig, *Social Security: Perspectives for Reform* (Washington, D.C.: Brookings Institution, 1968); John A. Brittain, *The Payroll Tax for Social Security* (Washington, D.C.: Brookings Institution, 1972); Donald O. Parsons and Douglas R. Munro, "Intergenerational Transfers in Social Security," in *The Crisis in Social Security: Problems and Prospects*, ed. Michael J. Boskin (San Francisco: Institute for Contemporary Studies, 1977); and Peter J. Ferrara, *Social Security—The Inherent Contradiction* (San Francisco: Cato Institute, 1980).

with those under private plans. The fact that OASDI is compulsory has no connection with whether or not it is insurance. The essence of insurance is broad pooling of the risks involved. OASDI, as a social insurance program, provides such pooling.

Social Insurance as "Welfare"

In recent years, many individuals (especially economists) have referred to OASDI as being a program with mixed characteristics, because it contains both "insurance" and "welfare" elements. They assert that the financing basis should be made rational by separating these two elements and meeting the cost of the welfare elements from general revenues. Actually, what is meant is the differentiation between individual-equity and social-adequacy characteristics. The proper meaning of "welfare," as used in the social security area, is public assistance.

Some people assert that the Hospital Insurance (HI) part of Medicare and the disability and survivor benefits of OASDI, all financed by payroll taxes, are not insurance but rather welfare. They go on to argue that the retirement benefits of OASDI have an entirely different character and that their financing is properly by payroll taxes.

All of these are truly "insurance" in the broad sense of the term that they involve a pooling of risks in a program that is governmentally administered and has definite provisions for the payment of benefits as a right and definite financing therefor. This, of course, is not the definition that applies to private insurance, because the elements of contractual rights and complete individual equity are not present in OASDI and HI, but this is what essentially distinguishes social insurance from private insurance.

Those who assert that HI is not "insurance" do so on the ground that the benefits are not related to earnings, as are those in OASDI. This is not a sufficiently distinguishing characteristic, because HI still has the broad sharing of the risks. Furthermore, OASDI does not by any means have a strictly proportionate relationship between benefits and previous earnings, and it pays relatively more costly benefits to those who were near retirement age when the program began than to young new entrants.

As to the disability and survivor benefits of OASDI, which are related to earnings, there is no reason why they should be called "welfare" instead of "insurance." Actually, there is more of an insurance element in these benefits than in the old-age benefits, because there is a relatively small probability that an insured worker will receive disability benefits or that family members will receive young-survivor benefits, whereas there is a very high probability that most workers, particularly the older ones, will receive retirement benefits.

Necessity for Compulsory Coverage under Social Insurance Programs

As indicated in the definition of social insurance in Appendix A, one basic distinguishing principle and feature is compulsory coverage, with only minor exceptions, of all categories of persons who are eligible for coverage in it.

The question is raised why people should not be allowed individually to decide whether they wish to participate in the social insurance program, especially those who are financially well off and who can (or believe they can) take care of themselves. Sometimes, those who express this view add the requirement that the individual obtain private-sector benefit coverage that is at least equal to that under the social insurance program.

It has also occasionally been advocated that employers with good private pension plans should be permitted to opt out of OASDI. When the program was first being considered in 1935, an intensive effort was made to allow such opting out (the Clark Amendment, discussed in some detail in Chapter 3). Among the problems of this approach are the possible insolvency of the private plan and the need to provide adequate protection for workers who leave the service of the employer prior to retirement.

Still another proposal along these lines would require all individuals below a certain age to withdraw (either partially or fully) from OASDI and to obtain private-sector benefit coverage. These various proposals, which may be termed "privatization," are almost always not well thought out as to indexation of benefits to recognize inflation or as to disability and survivors benefit coverage.

Obviously, voluntary coverage has great "political" appeal. Those who wish to be covered will be able to have coverage, and those who do not want coverage will have what they want, too. The only difficulty—and one that, in fact, is controlling—is that with such voluntary coverage, there would be significant antiselection against the program. The low-cost risks (young persons, high-salaried persons, unmarried persons, and women who expect to receive benefits from their husband's earnings record) would tend to opt out, and those with high costs would tend to remain in. This, in turn, would completely disrupt the financing of the program and would necessitate higher tax rates or some other source of financing, which might cause still more persons to opt out.

Another disadvantage of permitting general voluntary coverage is that some low-income persons for whom coverage might be financially advantageous would, nonetheless, opt out because they need the money now. In the long run, such persons would probably be destitute when old age, disability, or death strikes; so, government relief or assistance would then be required. It seems preferable to take care of such cases by the social insurance approach as much as is possible.

If there is the requirement of having at least equivalent protection in order to opt out, some antiselection will be avoided (as will the problem of some low-income persons imprudently opting out). Yet, so much antiselection will remain that the financing difficulties will be great.

In summary, then, although permitting general voluntary coverage might seem attractive at first glance, it is not at all feasible if the program is to be adequately and reasonably financed and to do the protection job for which it is intended.

Concept of Poverty

Historically, the concept of poverty was not developed as a scientific determination, such as has been done in evaluating the speed of light or the distance to the moon. Instead, it was developed as a political stratagem for the reelection campaign of President Kennedy in 1964. After his assassination, this theme was taken over by President Johnson for his campaign.

Initially, a figure of $3,000 per year was arbitrarily taken as the poverty threshold, without specifying the size of the family or its location. Subsequent refinements sharpened the concept so that this figure applied to a nonfarm family consisting of a married couple with two children. Then an entire framework of poverty levels was developed and projected into the future on the basis of changes in the cost of living.[5] No surveys were made at all as to what this initial "magical" $3,000 figure really meant in terms of living standards. Nor, in measuring poverty, is account taken of whether the family has assets such as homeownership or support from relatives or noncash income such as Medicare benefits, food stamps, or low-income energy assistance, which in fact have the same value to the individual as actual cash income. As to the value assigned to Medicare benefits, this should not be based on the value of the benefits actually received

5. These may be found in the various *Annual Statistical Supplements, Social Security Bulletin*, issued by the Social Security Administration.

(which would produce the ridiculous result that the sicker you are, the wealthier you are), but rather on the value of the protection (i.e., like an insurance policy premium).

As an example of a rather common situation where the individual is classified as being in poverty but by any reasonable standard really is not, consider an aged widow. Assume that she has an annual income of $5,500 (mostly from OASDI) and lives in her mortgage-free home worth $75,000. Assume further that she has a small garden, or that her children help her frequently by giving her gifts in cash or in kind, or even that her married son and his family live with her and pay a substantial part of the operating expenses of the house. Certainly she is making out reasonably well and is not really in "poverty" (as the official poverty index for 1990 indicates)—and she, no doubt, is proud of being able to take care of herself financially.

This omission of payments in kind in determining the extent of so-called poverty, and instead using only cash income, has been pointed out by the Congressional Budget Office in its report *Poverty Status of Families under Alternative Definitions of Income* (1977). The report points out that, whereas 14.1 percent of families were "in poverty" in fiscal year 1976 in terms of cash income, when account is taken of taxes and government income-in-kind payments, this figure is reduced by more than one half, to 6.9 percent.

Before this mechanistic definition of poverty was invented, the term *poverty* had more generally been used for the grinding type of repressed living and starvation that is so prevalent in many overpopulated, economically underdeveloped countries. Little of this is actually present in the United States, although its different usage of this term has no doubt been quite enthusiastically accepted for propaganda purposes by some of its political opponents. They can claim that, based on their definitions, their countries have no poverty, while the United States admits to having a significant amount.

In 1990 the annual poverty thresholds were reported as follows for certain selected nonfarm family groups.

Single person under age 65	$6,800
2-person family, head under age 65	8,794
Single person aged 65 or over	6,268
2-person family, head aged 65 or over	7,905

The overall poverty rate by this standard fell from 22.4 percent in 1959 to a plateau of about 11½ percent during 1972–79, rose to 15.2

percent in 1983, and then decreased to about 13½ percent in the late 1980s. The corresponding rate for persons aged 65 or over decreased from 35.2 percent in 1959 to a pleateau of about 15 percent in 1974–81, and then decreased to about 12½ percent in 1984 and after. It is interesting to note that in 1982, for the first time, the rate was lower for the aged than for the total population, and it has remained about 1½ percentage points lower thereafter.[6]

Comparisons of people's income with the poverty "standards" are frequently made. Usually, the "actual" incomes are derived from interview-survey data. The resulting poverty analysis tends to overstate the problem, because individuals frequently will underreport their incomes under such circumstances. A study by the Social Security Administration that compared income self-reported in a survey with that from income-tax records (sometimes underreported too) and from Social Security earnings records showed that, after correction, "the adjusted 1972 income of aged family units would be 41 percent higher than was reported."[7]

Social Security in the United States

A system of "social security" programs has been adopted in this country. The purpose of this book is to examine the nature of the primary "social security" program in the United States, the combination of the Old-Age, Survivors, and Disability Insurance system and the Medicare program. The magnitude and importance of this program are such that its description occupies the major portion of the book. Parts Two and Three are devoted exclusively to OASDI and Medicare respectively. Part Four briefly describes two related programs, public assistance and the Railroad Retirement system. Not considered here are other social security programs such as unemployment insurance, workers' compensation, and cash-sickness programs.

6. The source of these poverty figures is the Social Security Administration.
7. "Relative Importance of Various Income Sources of the Aged, 1980," *Social Security Bulletin*, January 1983, p. 4.