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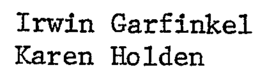

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CRISIS IN OLD AGE INSURANCE AND THE WELFARE STATE?

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ABSTRACT

The growth of the Old Age Insurance (OAI) program and more generally the welfare state has led many to argue that this increase in expenditures and taxes is undermining economic incentives and growth. Projected short- and long-run deficits in the OAI program are said to be symptomatic of the problem. By focusing on the financial crisis in the U.S. OAI program, we examine this alleged crisis in the welfare state. In the first section we discuss the historical development of the OAI system as one component of the expansion of the U.S. welfare system. In the second and third sections we discuss the short- and long-run financial problems in the U.S. OAI program and recent changes to solve these problems. We next review the evidence for the effect of the OAI program on economic incentives to work and save as well as the effects on economic insecurity, poverty, and inequality. The paper concludes with a discussion of the nature and severity of the crisis in the U.S. OAI program and the welfare state.

CRISES IN OLD AGE INSURANCE AND THE WELFARE STATE?

Irwin Garfinkel and Karen Holden

This paper is about the alleged crises in the U.S. Old Age Insurance Program (OAI) and, more broadly, the Western welfare state. Opponents of the growth of both OAI and the welfare state argue that we spend and therefore tax too much in these areas.[1] According to them, the recent tremendous growth in expenditures and taxes is undermining economic incentives and growth. Continuation along the same lines will bankrupt the nation. The fact that prior to the OAI tax increases enacted in March, 1983 scheduled OAI taxes in the U.S. were insufficient to finance OAI benefits by mid-1983 is symptomatic of the problem, as are projections which indicate that the shortfall between taxes and expenditures would get much worse early in the next century. There are also large deficits projected in the U.S. Health Insurance (HI) program.

By focusing on the financial crisis in the U.S. OAI program, we hope to shed some light on the alleged crisis in the Western welfare state, since the OAI program is a huge part of the welfare state, and the United States is the largest country in the West.

In the first section of the paper we discuss the historical development of the U.S. welfare state and place the U.S. OAI system in the context of the U.S. welfare state. In the second and third sections we discuss the short- and long-run financing problems in the U.S. OAI program and describe potential solutions to them. In the fourth section we examine the effects of the OAI program on economic insecurity, poverty, and inequality as well as the effects on economic incentives. In the concluding section we summarize the findings from previous sec-

tions on the nature and severity of the crisis in the U.S. OAI program and draw implications for the broader crisis in the Western welfare state.

I. OAI IN THE CONTEXT OF THE WELFARE STATE

The welfare state is a compromise between capitalism and socialism. Although the means of production remain largely in private hands, large segments of consumption, most notably in the areas of health, education, and the provision of income transfers, have been socialized. In addition, there is a commitment, recently honored only in the breach, to full employment. In our discussion of the welfare state we focus on public expenditures in the health, education, and income transfer areas.

The United States has the reputation of being a laggard in the development of the welfare state.[2] Yet in education, we pioneered. Both production and consumption in this area are now largely socialized. And on health care, where consumption, though not production, is now largely socialized, we spend a higher percentage of GNP than most other countries.[3] In the area of income transfers, we were slower to develop social insurance institutions and remain the only Western country without children's allowances. Despite this, public income transfers are big business in America.

The public education movement in the United States, led by Horace Mann, developed in the 1820s. By the 1860s, the movement won. All states provided free elementary and secondary education. One of the planks of Marx's famous 1848 Communist Manifesto was nearly achieved in America before the manifesto was issued. The United States continues to lead the world in secondary school enrollment. And only Canada has a

larger proportion of its population who acquire post-secondary education.[4] The U.S. emphasis on education is consistent with a dominant theme of the American creed: equality of opportunity.

From the outset, Americans also believed that care for the poor was a public responsibility. The first settlers brought with them the British Poor Law. By the late eighteenth century public assistance was one of the largest expenditure items in many American towns.

Throughout the nineteenth century, developments in public assistance in the United States were similar to developments in Great Britain.[5] Responsibility for public provision gradually shifted to higher levels of government. In the United States, states first took responsibility for the blind and insane. In the early twentieth century all states enacted Workmen's Compensation, about half enacted Widows' Assistance programs, and in the early 1930s Wisconsin and New York enacted unemployment insurance programs.

Until 1935, however, with two important exceptions, the U.S. federal government had assumed no responsibility for aiding the poor.[6] Moreover, though Germany and England had enacted old age insurance programs in 1889 and 1908 respectively, the United States had no public old age insurance programs.

The Great Depression of the 1930s led to a dramatic shift from state to federal responsibility because state and local governments were unable to cope with the large increase in economic hardship caused by a 20-25 percent unemployment rate. In 1935 President Roosevelt proposed and the Congress enacted the landmark Social Security Act that established the basic framework of the current U.S. social security system.

The 1935 Social Security Act created five programs. Two were social insurance programs in which eligibility and benefit levels were related to previous employment and contributions by the worker and/or his employer: Old Age Insurance (OAI) and Unemployment Insurance (UI). Three were income-tested programs in which eligibility and benefit levels depended on current income: Aid to the Blind (AB), Old Age Assistance (OAA), and Aid to Dependent Children (ADC).

Between 1935 and 1964, the Social Security Act was amended several times, gradually expanding coverage and benefit levels. In 1939 insurance benefits were extended to survivors of deceased workers (thereby adding survivors insurance (SI) to OAI) and to wives of retired workers. In 1950 and 1956 respectively first means-tested benefits, then insurance benefits (DI), were extended to the disabled. Moreover, the 1946 Full Employment Act added another, though rather weak as yet, pillar to the U.S. Welfare State.

Whereas the U.S. Federal government took its first giant steps towards the welfare state in the midst of the Great Depression, the next giant steps begin in the mid 1960s, that is in the midst of the most sustained period of economic growth in twentieth century U.S. history. The U.S. civil rights movement increased the political power of the single largest poor group in America, and thereby heightened awareness of racial injustice. In response, President Johnson in 1964 declared a "War on Poverty." He proposed, and Congress quickly enacted, the Economic Opportunity Act. This act created a series of education, employment and training programs such as Head Start, Job Corps, and the Community Action Programs, and set up the Office of Economic Opportunity to administer programs created by the act. While not having direct administrative

power over existing old age security programs, the Economic Opportunity Act had an indirect effect on these programs by elevating the question "What does it do for the poor?" to a test for judging government interventions and for orienting all national social welfare policy.[7]

In existing social welfare programs eligibility was extended and benefit levels were increased, leading to a consequent acceleration in program costs. Between 1965 and 1972, Congress raised benefits five times for a total increase of 84 per cent, compared to a change of only 35 percent in the Consumer Price Index of 1972. At the same time a 43 percent growth in the number of beneficiaires and higher earnings also raised costs, for a total increase of 150 percent. This program growth was largely responsible for the sharp drop in poverty among the aged. Whereas one of three people over age 65 was poor in 1964, only 14 percent of the aged were poor in 1972. In that year future OASDI benefits were indexed to both future wage growth and inflation. Since then the percentage of the aged in poverty, as measured by cash income alone, has remained relatively constant. If the cash value of in-kind benefits is included in the income measure, the proportion of aged who are poor has continued to decline to only 5 percent as of 1982.[8]

The emphasis on poverty and inequality also led to the enactment in 1965 of the Medicare and Medicaid programs. The former is a health insurance (HI) program for the aged, financed through a payroll tax on workers, the latter a medical assistance program for the poor. Medicare coverage was limited to persons 65 or older who were also eligible for benefits under OASDI; Medicaid is an income-tested program for which all age groups may qualify.

The election of Richard Nixon in 1968 did not at first slow the growth of federal social welfare expenditures. Nixon proposed a federal Family Assistance Plan (FAP), which would have provided a uniform nationwide minimum cash income to families with children, and to the aged, blind, and disabled. Although the proposal for a federal welfare program for families with children did not pass Congress, a means-tested nationwide program for the aged, blind, and disabled was enacted in 1972 as the Supplemental Security Income (SSI) program, replacing the Old Age Assistance and Aid to the Blind programs. Benefits to people with no other income were set at about 75 percent of the poverty level for a single individual and 90 percent for a couple. Increases in SSI benefits were tied to changes in the cost of living. In addition, the Food Stamps program, which was first enacted in 1964 to distribute food vouchers to needy families (including the aged) was extended nationwide in 1972.

By President Carter's election in 1976 the growth of federal social welfare expenditures as a percentage of GNP had stopped. Nevertheless, four years later in 1980 Ronald Reagan ran for the presidency, and won, on a platform that argued that the rapid growth in social programs had stifled economic incentives and growth. His 1982 Program for Economic Recovery was proposed as the instrument for reversing two decades of rapid growth in federal expenditures in nondefense programs.

Before President Reagan assumed power, federal social welfare expenditures (SWE) equalled about 55 percent of the federal budget and 12 percent of GNP.[9] Total social welfare expenditures were much larger, because elementary and secondary education are financed almost exclusively by state and local taxes, and because most personal health care is financed by employment-related group health insurance deductions from pay. Total SWE equalled 17 percent of GNP.

Despite all the talk about a counter-revolution, the Reagan proposals enacted to date have failed to reduce federal social welfare spending as a percentage of GNP. Large percentage reductions in selected income-tested programs have been implemented. But these programs are trivial by comparison to insurance and health-care programs, where costs continue to increase.[10] Most important, despite his pre-presidential opposition to the Social Security system and higher taxes, President Reagan recently recommended, and the Congress quickly adopted, changes in OASDI financing the entailed much larger tax increases than benefit decreases.

II. THE SHORT- AND LONG-RUN FISCAL PROBLEMS

A. More Specific Background on OAI

As of 1982, 88 percent of all U.S. workers were covered by the OASDI program. Only federal employees and some state and non-profit corporation workers were not covered.

In 1982 OASDI paid over $13 billion per month to almost 36 million retired and disabled workers and their spouses, widows, and dependents. Funds for the system are raised by a payroll tax which in 1983 equals 10.8 percent, shared equally by employer and employee, on the first $35,700 in wage (i.e., excluding selected fringe benefits) income. An additional 2.6 percent tax on covered wage income finances the hospital insurance program for the aged and disabled.

Benefits paid to retired and disabled workers depend on previous covered earnings. The benefit formula is progressive in that low earnings are replaced at a higher rate than high earnings. In addition, survivors and spouses are eligible for benefits based on the retired, deceased or disabled worders OASDI benefit.

The current-cost method of financing OASDI means that higher benefits must be financed through wage growth and/or higher payroll taxes. Prior to 1974 benefit increases required Congressional action. The 1972 Amendments put all benefit adjustments on an automatic basis. Retiree benefits are now adjusted by the annual change in the Consumer Price Index, while the contribution base and benefit formula are adjusted by the change in average wages. In addition, past covered wages are indexed to account for subsequent increases in real wages of all workers. Whether or not the now-automatic increases in benefits are fully financed by increases in contributions depends on the relative changes in average wages and prices. Although a "trust fund" exists, this is used only to absorb temporary fluctuations in benefit payments that do not conform to scheduled tax payments. The rapid decline in this fund was prior to the recently enacted tax and benefit changes was, however, an indication of the system's inability to meet all benefit payments through current revenues in the near future.

B. The Nature and Causes of the Problem

The financing crisis facing OASDI at the beginnning of 1983 was indicated by the necessity of borrowing from the DI and HI trust funds to meet all OASI payments on time and the predicted depletion of the combined OASDHI trust funds by 1985. The problem was short-run and temporary in that the most reasonable projections indicated that over the entire period of 1982-2006 legislated taxes were more than sufficient to cover predicted benefit payments.[11] The long-run problem was evident from projection for the period after 2006 which indicated that legislated taxes (12.4% of covered wages) would be well below the 15-16% necessary

to pay expected OASDI benefits. In both cases, the system could be balanced only by some adjustments in taxes or benefit payments.

The cause of the short-run financing problem is stagflation. Low productivity growth, higher price than wage increases and record high unemployment have led to payroll taxes far below that necessary to finance benefit payments. A predicted reversal of these economic conditions and a return to long-run growth rates would turn the short-run deficit into a small dividend equal to 1.0 to 1.5 percent of payroll after 1990 and an average annual balance of +.64 percent of taxable payroll over the years between 1982 and 2006.[12]

The cause of the predicted long-run problem is demographic. The post-World War II baby boom cohort reaches the age of 65 in 2011. Assuming a total fertility rate stable at 2.1, the ratio of the 65 and older to the 20-64 year old population is projected to increase from the current .2 to .38.[13] In the absence of other changes, this change in age structure will necessitate a near doubling in OASDI taxes paid by covered workers to keep retirees at the same standard of living as they now enjoy relative to the non-aged. Higher than projected labor force participation by either the non-aged (particularly women) or later than projected retirement by the aged or higher than projected productivity growth could help modify these expected tax increases. The most widely accepted projections on Social Security financing problems prior to the recent tax and benefit changes predicted a rise in OASDI taxes to close to 16 percent of taxable payroll from the current 10.8 percent. Alternatively, to keep tax rates unchanged, per person benefits to the aged would have to be reduced proportionately.

III. ALTERNATIVE SOLUTIONS TO FINANCING PROBLEMS

In 1982 President Reagan appointed a National Commission on Social Security Reform to report to him and the Congress on how to solve the system's financing problems. In January, 1983, the Commission issued a compromise proposal which largely addressed short-run problems, although each proposed change will reduce the long-run deficit as well. Because the causes of the short and long run problems differ and because they were separately addressed by the Commission, we will discuss their solutions separately.

A. Short-Run Solutions

The two major proposals made by the Commission for increasing tax revenues in the short run were (1) to advance to 1983 all or part of OASDI tax increase already legislated for 1990, and (2) to expand OASDI coverage to noncovered federal and state employees and to employees of nonprofit corporations. The latter was desirable and advocated by reformers for years independent of financing considerations.[14] In addition to their civil service pensions, many retired federal civil service workers were able to qualify for minimum social security benefits intended for low-wage workers by working for only a few years in covered unemployment. This abuse of the program prompted its advocates to push for inclusion of all workers. Opponents of the progressivity of the benefit structure, however, used the abuse to argue for elimination of the minimum benefit.[15]

Another tax increase of independent merit which raises less revenue, however, is to increase the payroll tax on the self-employed from .75 times the combined employer and employee tax rate for wage earners, to

the full amount of the combined rates. Because nearly all economists agree that the employer share of the payroll tax is borne almost in whole by labor, the lower rate on the self-employed was viewed by many as unfair.[16]

The major proposals for reducing benefits were (1) to postpone cost-of-living increases in benefits, and (2) to tax benefits. Again, the latter has independent merit and has been advocated for years by tax reformers from both ends of the political spectrum.[17] Social security benefits are income. To advocates of a comprehensive income tax base, there is no convincing rationale for excluding income from social insurance benefits. The argument that taxing social security will hurt the poor is nonsense. In the U.S., the aged poor pay no income taxes under the progressive income tax. In addition, by not taxing OASDI benefits, a large percentage of the income of the non-poor aged is sheltered against taxes, even though the average per capita income of the aged is now nearly equal to that of the non-aged.[18] Nor can one argue that benefits should not be taxed on the basis that they are merely a benefit based on prior contributions. The currently retired population has received enormous windfalls from entering the social security system in its infancy.[19] During their working years, they supported a system which paid many fewer kinds of benefits at a much less generous level. Taxing benefits is the most equitable way to reduce them and not hurt poor beneficiaries.

These five proposals were projected to raise taxes and cut benefits by $151.0 billion between 1983 and 1980.[20] Including newly employed non-covered federal, and voluntary sector workers as of 1984, and asking the withdrawal of state employees, partly advancing the already scheduled tax increase and increasing the rate on the self-employed would increase

taxes respectively by $22, $40 and $18 billion. Counting one-half of benefits for income tax purposes for those with incomes in excess of $25,000 ($32,000 for a married couple), was projected to raise an additiona $27 billion in program revenues. Postponing the next scheduled cost-of-living increase from July, 1983 to January 1984 would decrease benefit payments by $40 billion. Depending upon whether taxing benefits is considered an increase in taxes or a reduction in benefits, therefore, one-half to two-thirds of the solution recommended by the Commission relied upon increased taxation rather than expenditure reduction. President Reagan endorsed the Commission's recommendations and Congress quickly adopted them along with a more controversial additional proposal to address the long term financing problem.

B. Long Run Solutions

The major alternatives which could have been proposed by the Commission for solving the long run financing problem are: (1) to raise the retirement age, (2) to reduce benefit levels relative to the standard of living of the working age population, (3) to increase tax rates after 2006 on the social security payroll; and (4) to increase immigration of working age people.

The actuarial argument for increasing the retirement age is straightforward. Life expectancy has increased since 1935 and is expected to continue to increase into the future. In 1940, expectation of life at 65 was 11.9 years for men and 13.4 years for women. In 1980 men and women could expect to live respectively 14 and 18.4 years beyond age 65.[21] By not changing retirement age, the program has by implication assumed that all the additional years of adult life would be spent in retirement, therey increasing benefit costs without an equivalent increase in

taxes.[22] An increase in retirement age would reallocate some of this improvement to the working age period, thereby increasing life-time taxes and reducing life-time benefits of future beneficiaries.

Relative to an equivalent size across the board reduction in benefit levels, however, increasing the retirement age is likely to be disproportionately harmful to the poor, to blacks, and probably to women as well. The poor and blacks are now more likely than the nonpoor majority groups to die before they collect benefits.[23] Unless these gaps are narrowed in the future, raising the retirement age is likely to exacerbate this problem. While women live longer than men, they are now more likely to retire early. Increasing the retirement age will increase the penalty for early retirement and is therefore more likely to reduce relative levels of incomes for women as well as those who retire on early benefits after a period of unemployment.

Reducing benefits relative to the standard of living of the working-age population is attractive because it can be achieved without making the aged less well off in an absolute sense. Indeed, if average living standards continue to rise, benefits to the aged and their standard of living in the twenty-first century can be much higher than now even though their status relative to the nonaged declines. Reducing benefits relative to the standard of living of the nonaged is unattractive because it erodes the achievement of the 1960s of equalizing or nearly equalizing the economic status of the aged and nonaged. The 1972 social security amendments which indexed benefits to both wage growth and inflation were designed to ensure that this achievement persisted.

Increasing payroll tax rates to cover the long-run deficit is attractive because it neither discriminates against the poor, blacks, and women, nor reduces the relative status of the aged. Social Security tax

rates would not have to exceed levels already prevailing in some West European countries.[24] Furthermore, although the ratio of the population age 65 and older to the population age 20-64 is predicted to double to 2060, the very same projections forecast a dramatic fall in the under-20 population. Consequently, the total dependency ratio (those under 20 plus those over 65 to the population 20-64) will actually fall from .75 to .68 in 2010, after which it will rise slightly to .86 by 2060. It is important to note that this last ratio is well below the dependency ratio . 95 of 1965. Thus, while OASDI may be faced by unfavorable demographic trends in the future, these same trends are not alarming when one considers the entire social welfare system including education and the distribution of benefits among dependent population groups. It is therefore possible that the near equal economic status of the aged and non-aged can be retained without increasing the total tax burden of the working population. The disadvantage to this solution is that it entails a massive redistribution of public expenditures from the young to the old. How far a progressive nation wants to go in this direction is an important policy question. In any case, in the current political context, a near doubling of payroll tax rates, even if accompanied by a proposed offsetting reduction in other taxes, is hardly palatable.

Increasing legal immigration would reduce projected payroll taxes to some degree as new immigrants expand the tax paying population immediately, while causing an increase in beneficiaries only in the future. Continued immigration would asslow the time lag effect to continue in the future. To the extent that illegal immigration into the U.S. (estimated between 1-3 million per year) expands the tax paying but not the beneficiary population the rest of us are subsidized. (Employers report wages,

but individuals may fear detection if they later apply for benefits.) Increasing legal immigration would also constitute a partial return to America's previous proud policy of open immigration. The disadvantage is that mass immigration brings serious adjustment and integration problems of its own.

Unfortunately Congress in its haste to adopt the National Commission's unanimous short term recommendations also adopted the Republican members recommendation for increasing the retirement age. Beginning in 2003, the retirement age will increase in to stages to 67 by 2027. In view of the fact that the first stage is not scheduled to take full effect until 2009 it would seem that the Congress had time to more carefully consider the alternatives. On the other hand, there is now plenty of time for Congress to reconsider and change their action in a noncrisis atmosphere. The short-run financing problem of the OAI program was trivial in that relatively small tax or benefit changes were required. Addressing the long-run problem, while not trivial, is clearly manageable. Is there anything more fundamentally problematic about the OASDI program? The next section considers first the negative, then the positive economic effects of the OAI program.

IV. THE ECONOMIC EFFECTS OF OASDI

The OASDI program is charged with reducing savings and work. By providing a public retirement program it may have reduced private savings for retirement. By providing retirement income OASDI may also have reduced work effort at all ages, especially at the end of the working-age life. If all households save and invest less, there will be less capital per worker. Each worker will produce less. Similarly, lower work effort

means less production. This chain of events is supported by the casual observation that the impressive post-World War II economic growth in Western Europe and the United States bogged down into the stagflation of the mid-1970s and early 1980s soon after the tremendous expansion during the mid-1960s and early 1970s of OAI and the welfare state. Is this mere coincidence, or is there a causal connection? The crisis of the welfare state arises largely from the belief that the expansion of income transfers and higher taxes to finance these programs is responsible for the poor performance of the U.S and European economies.

Economic theory does not clearly predict the effect of OAI on private savings. Because OASDI is a pay-as-you-go system, current workers get the protection of a savings plan (so long as they believe the system will continue to pay benefits when they retire) without the need to save. Consequently, they will save less. On the other hand, because some U.S. provisions encourage earlier and therefore longer retirement, they may save more than in the absence of a public retirement program. Although there are many other reasons for believing that social security will increase, decrease, or have no effect on savings, these two suffice to make the point. The effect of OAI on savings is an empirical question!

Unfortunately, the empirical evidence provides no better guidance than theory. Feldstein found a huge negative effect of OASDI on savings.[25] His finding sparked additional research whose results in general did not support Feldstein's findings.[26] Recently two researchers discovered that Feldstein's original results were attributable to a programming error.[27] The corrected results suggest that social security actually increased savings.

Economic theory is less ambiguous about the effects of most transfers on work. From an economy-wide perspective, income transfers reduce work. Beneficiaries work less because they have more income. On the other hand, those who finance the benefits work more because they have less income. To a first approximation these income effects cancel each other out. But both the explicit tax rates required to raise revenue to finance the benefits and the implicit tax rates on beneficiaries which accompany most transfers reduce the relative reward for work. But theory says nothing about the magnitude of the reductions in work effort. Very small and very large effects are equally consistent with the theory. And studies have found both.[28] Moreover, because OASDI benefits depend upon previous earnings and therefore upon work effort during working age, the OASDI program may increase work and earnings prior to retirement age. Only one study has attempted to measure this work incentive effects. It found positive effects on the hours of young workers.[29] On balance, therefore, we cannot even say for sure that the OAI program has caused reductions in work.

Perhaps the most convincing evidence that OASDI has had a nontrivial effect on work effort is the dramatic increase after World War II in the proportion of males over age 65 in the United States who are retired. On the other hand, the trend began before the 1935 Social Security Act. Moreover, income from private pensions and other forms of savings and wealth also increased rapidly during the post World-War II period. Increasing income in general rather than OAI alone may account for most of both the pre- and post-World War II trends.

Although the alleged ill effects of OASDI on savings and work are difficult to verify, let alone quantify, the positive effects on poverty,

inequality, and insecurity are demonstrable. As noted above, the increase in OAI benefits between 1965 and 1972 cut poverty among the aged by more than half. Moreover, research indicates OASDI has disproportionately benefited women, low-wage, and minority workers.[30] Although average workers enter the labor force later and live longer than low-wage and minority workers, and although the payroll tax is somewhat regressive, the progressive tilt in the social security benefit structure more than compensates for all these. In the absence of the progressive tilt in the benefit structure, however, social security would be unfair to low-wage workers. Advocates of its elimination in the name of actuarial equity overlook this point. Surely if a social rather than private insurance system errs in any direction in terms of actuarial fairness, it ought to err in the direction of the poor.

Similarly, as noted above, thanks in large measure to OASDI, the economic status of the aged and nonaged is now nearly equivalent. This is evidence of both a dramatic decrease in inequality among age groups and a reduction in economic insecurity due to age. The elderly who received benefits soon after the system was created clearly got a better relative deal from the system than those who followed. Current retirees still get much more out of than they put into the system. Some analysts claim that current workers will put much more into than they will get out of the system. The best research on the issue, however, indicates that the rate of return to workers entering the labor force between the years 1960 and 2000 will range from 2.6 to 4.9 percent.[31] Even if a comparable investment were available in the private sector, this would be a very respectable return. But comparable inflation-proof protection against not only old age, but disability, widowhood, etc., cannot be bought in the private

sector. This inflation-proof protection against this wide variety of risks raises the insurance value of OASDI coverage well beyond its value as a pension program. The argument that social security is a raw deal for young workers which has helped to fuel the "crisis in the welfare state" does not hold up under inspection.

V. SUMMARY AND CONCLUSION

Spurred by the 1960s civil rights movement, heightened social awareness and unprecedented prosperity, the War on Poverty and the U.S. welfare state grew at a breathtaking rate during the 1965-75 decade. Towards the end of the period stagflation began. A political reaction was inevitable. The great deal of attention to the alleged crisis in OASDI and the welfare state is the result. The questions involved were fundamental. Should the large growth in OASDI and the welfare state be repealed? Were the OASDI financing problems going to be used as a pretext for dismantling the OASDI program?

President Reagan, a longtime opponent of the very institution of a public old age insurance system, and the Congress have now answered these questions clearly. OASDI is here to stay. Rather than dismantling the program, the crisis atmosphere generated by the short-run financing problem was used to strengthen the program. The unanimous recommendations of the Commission on Social Security Reform were endorsed by Reagan and quickly and overwhelmingly passed by the Congress. The package was a sensible compromise that embodied only a few major changes (including most notably inclusion of new federal, state and voluntary agency workers and the taxation of benefits) that should have been made

in their own right. Although the Congress acted precipitately in passing legislation to raise the retirement age gradually, beginning in the year 2003, the common sense appeal of this proposal is obvious. There is nothing magical about age 65. Longevity is increasing. Norway, Israel and Denmark have later retirement ages. In any case, there is plenty of time for Congress to reconsider the change.

Neither the short- nor the long-run financing problems posed a serious threat to the existence of the OASDI program; solutions were available that would preserve the program without reducing its ability to prvide a guaranteed income to the aged, disabled and their survivors. Nor is there any convincing evidence that OASDI has helped to kill the goose that was laying the golden eggs. Perhaps OAI has reduced savings and work effort. Perhaps not. The evidence is not convincing either way.

If the problems of the OASDI program are a fair sampling of the problems of the welfare state, there may or may not be a crisis of the welfare state, but there is certainly no need to panic. Indeed, the potential national benefits of public education and to a lesser extent pubicly financed medical care seem even more promising than those in the income transfer area. Education and health benefits have undoubtedly increased both the quantity and quality of the labor force.

On the other hand, although the financial problems in each part of the welfare state may seem solvable when considered alone, one at a time, there may be a commonality to them, such that when taken together they are not solvable. This would be true if the tax burden for each program considered alone was reasonable, but the tax burden of all the programs taken together was too high. How high a tax to finance all social

welfare programs is too high? All but the most doctrinaire socialists will agree that 100 percent is too high. Economic incentives are too important and potent a tool for sensible social and economic systmes to do without. Consequently, more is not always better.

Nor are existing programs without problems. Despite the huge increases in OASDI bnefits, 30 percent of all aged widows in the United States remain poor. Dependents' benefits in the OAI system which are justified on an anti-poverty basis are a based on the worker's prior covered earnings, an amount which may or may not raise families and survivors out of poverty. Upper income workers and their families will receive higher absolute benefits. A higher perecntage of working wives and growing unemployment among single worker families (including female heads may force future changes in how earnings and benefits are calculated. The relative roles of OASDI and the Supplemental Security Income program in providing an income floor to low income aged is still in dispute. Technological improvements and cost increases in U.S. health care are equally dramatic. Painful choices about both must be made. Furthermore, the projected deficits in the Old Age Health Insurance System will require either large payroll tax increase or benefit decrease, or health care cost controls, alternative financing or some combination of thes. Finally, millions of families have lost health insurance coverage due to the post-Depression record high levels of unemployment. Indeed, record high unemployment is the most serious problem confronting the welfare state as it raises welfare program costs, reduces private insurance coverage, and lowers the number of workers supporting the welfare state.

Yet, if the response of the U.S. political system to the recent social security financial crisis is an indication of the response we can expect to the broader crisis of the welfare state, the welfare state is not in danger.

Notes

[1]OECD, The Welfare State in Crisis (OECD, Paris, 1981); Peter G. Peterson, "Social Security: The Coming Crisis," New York Review, Dec. 2, 1982, and "A Reply to Critics," New York Review, March 17, 1983.

[2]Arnold J. Heidenheimer with John Layson, "Social Policy Development in Europe and America: A Longer View on Selectivity and Income Testing," in I. Garfinkel (ed.), Income-Tested Transfer Programs: The Case For and Against (Academic Press, New York, 1982), pp. 141-163.

[3]Robert M. Gibson and Daniel R. Waldo, "National Health Care Expenditures, 1980," Health Care Financing Review, September 1981, pp. 11-13. Consumption is two-thirds socialized. Group health insurance accounts for 27 percent and government expenditures for 40 percent of personal health care costs. See "Sharing Health Costs," National Center for Health Services Research, U.S. Department of HEW, Pub. No. (PHS) 79-3256, Feb. 1980, p. 2.

[4]World Bank, Education, Sector Working Paper (World Bank, Washington D.C., 1974).

[5]See Karl de Schweinity, England's Road to Social Security (University of Pennsylvania Press, Philadelphia, 1943).

[6]The exceptions, both products of the American Civil War, were aid to veterans and their widows and orphans and the short-lived Freedman's Bureau, which provided aid to former slaves.

[7]Robert J. Lampman, "What does it do for the poor? A new test for national policy," Public Interest, 34 (1974), 66-82.

[8]See Timothy Smeeding, Alternative Methods for Valuing Selected In Kind Transfer Benefits and Measuring Their Effects on Poverty. Technical Paper #50 (U.S. Department of Commerce, Bureau of the Census, Washington D.C., March 1982), p. 89.

[9]A. W. McMillan, and A. K. Bixby, "Social Welfare Expenditures, Fiscal Year 1978," Social Security Bulletin, 43 (1980)(5), 3-17.

[10]See John L. Palmer and Isabel V. Sawhill, eds., The Reagan Experiment (Urban Institute Press, Washington, D.C., 1982), Chapter 3.

[11]Board of Trustees, Federal Old-Age and Survivors Insurance-Disability Insurance Trust Funds, 1982 Annual Report (USGPO, Washington, D.C., 1982). The Trustees issued four projections. We cite figures from the "intermediate" projections (Series II-B) on the grounds that these seem most reasonable. See Peterson, op. cit., for another view on this and the discussion below.

[12]Ibid.

[13]Ibid.

[14]See Joseph A. Pechman, Henry Aaron, and Michael K. Taussig, Social Security: Perspectives for Reform (The Brookings Institution, Washington, D.C., 1968), p. 220, for inclusion of federal workers.

[15]See Alicia H. Munnell, The Future of Social Security (The Brookings Institution Washington, D.C., 1968), p. 220.

[16]See John A. Brittain, The Payroll Tax for Social Security (The Brookings Institution, Washington, D.C., 1972).

[17]See Pechman et al., op. cit., pp. 202-204, and Munnell, op. cit., pp. 29-30.

[18]S. Danziger, J. van der Gaag, E. Smolensky, and M. Taussig, "Income Transfers and the Economic Status of the Elderly," in M. Moon (ed.), Social Accounting for Transfers, National Bureau of Economic Research Studies in Income and Wealth, Vol. 48, 1983.

[19]R. V. Burkhauser and J. Warlick, "Disentangling the Annuity from the Redistributive Aspects of Social Security," Review of Income and Wealth, 27 (1981), 401-421.

[20]Additional changes are expected to save another $17 billion.

[21]U.S. Department of Health and Human Services, Life Tables for the United States: 1900-2050, Actuarial Study No. 87 (U.S. Department of Health and Human Services, Washington, D.C., SSA Pub. No. 11-11534, September 1982).

[22]F. R. Bayo and J. F. Fabeo. Equivalent Retirement Ages: 1940-2050, Actuarial Note No. 105 (U.S. Department of Health and Human Services, Washington, D.C., June 1981).

[23]Gordon Sutton, "Demographic and Economic Differences in Survivor Experiences of Nonwhite and White Families," Social Security Bulletin, 43 (1980) (2), 18-20.

[24]OASDI programs are financed by a total payroll contribution rate of 21.1 in Austria, 18.5 in the Federal Republic of Germany, 32.45 in The Netherlands, and 21.15 in Sweden. I. R. Zeitzer, "Social Security Trends and Developments in Industrialized Countries," Social Security Bulletin, 46 (1983) (3) 52-62.

[25]M. Feldstein, "Social Security, Induced Retirement and Aggregate Capital Accumulation," Journal of Political Economy, 82 (Sept.-Oct. 1974), 905-926. Also M. Feldstein, "Social Security and Private Savings:

International Evidence in an Extended Lifecycle Model," in M. Feldstein and R. Inman (eds.), The Economics of Public Services, International Economic Association Conference Volume, 1977.

[26]For example:

Alicia H. Munnell, "The Impact of Social Security on Personal Saving," National Tax Journal, 27 (Dec. 1974), pp. 553-567, and The Effect of Social Security on Personal Savings (Brookings Institution, Washington D.C., 1982).

R. J. Barro, The Impact of Social Security on Private Saving: Evidence from the U.S. Time Series (The American Enterprise Institute for Public Policy Research, Washington, D.C., 1978).

M. R. Darby, The Effects of Social Security on Income and the Capital Stock (The American Enterprise Institute for Public Policy Research, Washington, D.C., 1978).

[27]D. R. Leimer and S. Lesnoy "Social Security and Private Saving: New Time Series Evidence," Journal of Political Economy, 90 (June 1982), 606-642.

[28]See S. Masters and I. Garfinkel, Estimating the Labor Supply Effects of Income Maintenance Programs (Academic Press, New York, 1977).

[29]R. V. Burkhauser and J. A. Turner, "A Time-Series Analysis on Social Security and Its Effects on the Market Work of Men at Younger Ages," Journal of Political Economy, 86 (August 1978), 701-715.

[30]Henry Aaron, Economic Effects of Social Security (Brookings Institution, Washington, D.C., 1982), pp. 78-80.

[31]L. Russell, The Baby Boom Generation and the Economy (Brookings Institution, Washington, D.C., 1982), pp. 153-158; D. R. Leimer and P. A. Petri, "Cohort Specific Effects of Social Security Policy," National Tax Journal, 34 (March 1981), 9-28.