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CHAPTER 12

Social Security Taxes

THE SOCIAL SECURITY TAXES include the general old age annuity and unemployment insurance taxes as well as the special taxes laid with respect to railroad employment. For old age annuities employers and workers each pay 1 per cent on wages. The employer makes both payments, deducting the worker's share from his wages. According to present legislation, the rate paid by each will be advanced to 2 per cent on January 1, 1943, and by the beginning of 1949 will reach a maximum of 3 per cent.

The unemployment insurance tax, paid by employers alone, is 3 per cent of wage payments. The combined levy on payrolls, now 2 per cent for old age annuities and 3 per cent for unemployment insurance, or a total of 5 per cent, will be 9 per cent by 1949, 6 per cent for old age pensions and 3 per cent for unemployment insurance.[1] These taxes apply to most wage payments of $3,000 or less. The chief exceptions are the wages of governmental and railroad employees, agricultural and casual laborers, workers in nonprofit organizations of a religious, charitable, educational, literary, or scientific character, and in domestic service; but the exceptions differ somewhat for the two taxes.

The wages of railroad employees up to $300 a month are taxed 3 per cent to both the employees and the railroad in order to provide the former with an annuity on retirement. The railroad deducts the employee's share from his wages and remits it to the Railroad Retirement Board. Ten per cent of the revenue is deposited in a special fund earmarked for the expenses of administering unemployment insurance benefits. So much of the remaining 90 per cent as is not required for current needs is deposited in an unemployment insurance account with the Treasury. These funds are invested by the Secretary of the Treasury, under the direction of the Railroad Retirement Board, in federal bonds yielding not less than 3 per cent. Under the present law the rates of these taxes will, after several advances, be stabilized at 3¾ per cent at the beginning of 1949. The railroad, but not the employee, also pays a tax of 3 per cent on the same basis to provide unemployment insurance. This combined rate of 9 per cent laid on railroad payrolls will eventually be 10½ per cent.

The Bureau of Internal Revenue collects the general old age annuity and unemployment insurance taxes as well as the railroad retirement taxes. The proceeds from the old age annuity tax are deposited in the Federal Old Age and Survivors Trust Fund. Money not needed for current payments is invested by the Secretary of the Treasury, trustee of the Fund, in federal obligations.

Since the federal government allows credits up to 90 per cent of its own unemployment insurance tax for taxes paid under approved state unemployment insurance plans, the taxes actually collected in this field are mainly those levied by the states. The unemployment insurance taxes collected by the states are deposited in the Unemployment Trust Fund of the Treasury, which keeps an account with each state, and invests any money not withdrawn for current payments in federal obligations. Because of the credit (90 per cent of the tax levied under federal law) for state unemployment insurance taxes paid, the federal unemployment insurance tax yields a relatively small annual revenue to the Treasury. From this amount, grants are made to the states to meet the cost of administering unemployment insurance programs.

Collections from all the social security levies are deposited in trust funds held by the Treasury. Accordingly, social security tax revenues which are not needed to finance current obligations incurred under the accompanying program of aid to workers are made available for the general purposes of government through loans to the Treasury by the trustee of the Fund. Since the old age annuity program has not yet reached maturity the currently collected taxes exceed the benefits paid. The railroad retirement program alone pays benefits equal to or greater than the taxes collected. The unemployment insurance program, started as it was in the midst of the great depression, has thus far experienced a net excess of receipts over disbursements, despite a liberalization of benefit provisions in some states, because of declining unemployment, higher wages, and the growth in number of workers covered.

In the fiscal year 1941 the Federal Old Age and Survivors Trust Fund was credited with deposits of $688.1 million from the old age annuity tax and $56 million interest, or a total of $744.1 million; expenditures were $91.2 million. The Railroad Retirement account received $116.1 million and expended $121.2 million; and the Unemployment Trust Fund, in which both the state and the railroad unemployment reserves are kept, received deposits of $1,009.9 million and expended $451.4 million. Deposits in all these trust funds exceeded expenditures by $1,236.3 million.[2] As the war economy becomes more active, more workers will be employed, and wage payments will increase, because of both greater aggregate working time and higher wage rates. During the next few years the excess of social security tax collections over expenditures is likely to increase. And, as has been observed, the entire excess, beyond cash reserves, goes to the Treasury in exchange for its obligations.

1 ADDITIONAL USE OF SOCIAL SECURITY TAXES IN WAR FINANCE

The need for absorbing general spending power, and doing so promptly as income expands, leads naturally to the suggestion that additional use be made of social security taxes in the present situation. Taxes on wages absorb funds which would otherwise be spent for civilian goods generally. Also they have the advantage that they are collected promptly. The money paid to the government, being deducted from wage payments by the employer, never gets into the possession of the taxpayer, who has, therefore, no opportunity to spend it.

That the revenue possibilities of such a proposal are large may be seen from the yield of the old age annuity tax, $690.5 million in the fiscal year 1941 when levied at a combined rate of 2 per cent. Its yield in the fiscal year 1942 is estimated at about $900 million. Doubling the rate would probably double the revenue. A rate of 5 per cent, which would be below the corresponding tax on railroad payrolls and would not represent an extreme increase as compared with the increases in the taxation of lower bracket incomes made by the Revenue Act of 1941, would add more than $1,100 million to the present yield. If at the same time the coverage were broadened significantly, the revenue would be much larger. Indeed, it seems probable that as much as $1.5 billion of additional revenue could be realized. Heavier taxation for unemployment insurance and related purposes would yield large additional sums for the Treasury, though chiefly in the form of loans from trust funds held in the name of the states.[3]

2 FUTURE BENEFITS

But social security levies are not ordinary taxes. In effect they are compulsory insurance premiums paid for benefits dispensed when unemployment or old age and retirement comes. The suggestion that social security taxes be used to absorb additional spending power probably implies a corresponding increase of future benefits to the workers whose wages would be taxed. These additional benefits could be either of two sorts: an increase in the types of benefit now given, that is, larger pensions for retired workers and more liberal unemployment advances; or new types of benefit.

The substantial and growing demand for enlarging the benefits provided by the social security program takes several forms. The existence of a large number of workers outside the combined systems creates continuing pressure to broaden the coverage, for the question why some workers are given and others denied protection will not down. Mr. Altmeyer, Chairman of the Social Security Board, favors a wider coverage,[4] and the President approves. Both the needs of retired workers and the contrast between the annuities purchased by contributions and the state pensions to needy old persons favor larger retirement annuities. Similarly, a case can be made for larger unemployment benefits. In most states unemployment benefits are small and available for relatively short periods. The inadequacy of the relief has led to a demand for federalizing the system of unemployment insurance and giving larger unemployment allowances.

We do not examine the merits of any demand that the self-financing benefits of the social security program be extended. To do so would be to venture into policy considerations beyond the field of this inquiry. But if on independent grounds the taxes and benefits are to be enlarged, a special advantage attaches to taking that step now. The immediate additions to tax revenues would presumably exceed the immediate increases in benefit disbursements, and hence would achieve a net reduction in current civilian spending power.

In the present situation, however, the emphasis of some Administration spokesmen has been on new but temporary social security benefits which would terminate with reference to a given time or contingency following the end of the war. From governmental quarters has come the proposal for a 'separation' or 'dismissal' wage. This payment, the amount of the tax with accumulated interest, would be made to the worker on his first change of employment after the war, thereby assisting him in transferring from armament to civilian production. J. M. Keynes' proposal of a tax on wages to be treated as a deferred payment, being taken from the worker during the war but returned with interest on the appearance of the first postwar slump,[5] has already been adopted in its essential features in Britain.

Either method raises a fundamental question. Workers together with other persons will have to consume less, during the war, of an ever widening variety of products. Some of the products, especially those made of metal, compete with the production of armament, and some are in short supply because of lack of shipping or other obstacles. Others are necessary for the health and comfort of soldiers and sailors, or for the civilian population of Great Britain or other allies. If prices are not to be inflated, this decline in consumption must be accompanied by a decline in civilian spending. But, except as it is incidental to the working of a long range plan, to hold that workers ought to consume less and be taxed more in a time of general scarcity need not imply that they ought to be compensated later. The one position is inherent in the situation; it does not necessarily support the other. Why then should not the one financial counterpart of this lessened wartime consumption be some *general* tax such as the personal income tax along lines elaborated above, for which no subsequent reimbursement would be made? Keynes apparently holds that a primary purpose of his plan is to provide a future compensation, not feasible at present, for the current unusual privations and extra long hours of labor.

The argument of those advocating a separation wage or deferred payment apparently includes also in varying proportions a compounding of alleged desirable gains from the redistribution of wealth involved, and the remedying or at least mitigation of an expected postwar depression. In one place Keynes says, "The complete scheme now proposed . . . embodies an advance towards economic equality greater than any which we have made in recent times"; and in another, "the system of deferment will be twice blessed; and will do almost as much good hereafter in preventing deflation and unemployment as it does now in preventing inflation and the exhaustion of scarce resources." [6] We shall not discuss the redistribution of wealth in general, or the special claims for this method of accomplishing that end. Our concern is rather with the contention that social security taxation can be used to facilitate adjustment to a peacetime economy.

Individual workers changing from wartime to peacetime tasks may suffer temporary loss of income that could be compensated by a separation wage, or workers generally may in a serious postwar depression need such aid as would be given by a wage deferred from the war period. But it is not certain that either problem will appear at the close of the war, or that if it does, the remedies proposed are the most suitable. The first problem is really a phase of the second, for in the absence of a depression no general problem of transfer from one type of employment to another arises. Conceivably, a depression might follow hard upon the heels of the war, but no grounds exist for translating such a possibility into an assumption. The close of the first World War was followed by a boom, succeeded by a sharp but short slump, then by a renewed burst of prosperity which lasted, except for minor slumps in 1924 and 1927, until 1930. The release of pent-up demand for automobiles, houses, and other durable goods was important in both the generation and the maintenance of the boom.

If, on the other hand, a severe economic depression should materialize with the coming of peace, payment of a deferred or a separation wage might support the economy. These devices would have the advantage of operating in direct unforced fashion by an arrangement well understood. Depending on the situation, however, other methods might be more effective. For example, increased investment might bring a better response than consumer spending. Yet the adoption of either the deferred payment or the separation wage device would bind the government to it and thereby impede the adoption, if they should prove necessary, of opposite measures to prevent a post-war inflation.[7]

3 RELATION TO THE INCOME TAX

The possibility of enlarging the collections of the social security system suggests a comparison with the individual income tax. Yielding large revenues, both taxes would be effective in absorbing incomes. But there are important differences between them and both cannot be applied severely at the same time.

The individual income tax, as the name suggests, is laid directly on the income of individuals. Taxable income from all sources, less a personal exemption and credit for dependents, is subject to this impost. Social security taxes are applied specifically to wages and salaries, and are paid partly by the worker and partly by the employer. In each instance, the levy is on a gross basis, no deductions or personal allowances being permitted.

Under the income tax, incomes are differentiated by size for taxation at graduated rates. Social security taxes, on the other hand, are laid at uniform rates, on wages and salaries up to $3,000 a year. Consequently they are a smaller percentage of a large income (above $3,000) than of a small. The income tax is a contribution to the cost of government from which the taxpayer may expect no special benefit. From social security taxes a fund is accumulated from which benefits to the worker are financed. The revenue from the income tax is delayed unless and to the extent that it is collected at the source. The unemployment insurance and old age annuity taxes differ with respect to currency of collection. Revenue from the unemployment insurance tax lags—on the average, more than half a year—far behind the wage payment on which it is collected, though this lag could probably be reduced. From the old age annuity tax, on the other hand, which yields much more revenue, the revenue is current. The money deducted from payrolls never even comes into the possession of the worker, and the tax money paid by the employer does not remain in his account long.

The point of this comparison is, however, differences having special significance for our problem. First, since social security taxes, viewed as a whole, yield a current revenue, the dollars collected have less opportunity to inflate prices than have dollars collected after some delay—longer or shorter, according to the arrangements for collection at source—by means of the income tax.

The second difference is in the obligation for payment: under the individual income tax it is direct. As a person receives income, so must he pay a tax. Only half of the old age annuity tax is legally deductible from wages. The rest is levied upon the employer, who must pay also the entire unemployment insurance tax. We are aware that according to many economists, social security taxes, irrespective of who pays them in a legal sense, tend to be borne by the worker.[8] But this result can come about only through long time adjustment in wage contracts, a kind of adjustment peculiarly difficult during a war boom. If the rates of either the old age annuity or the unemployment insurance tax were to be raised, prompt adjustment would be desirable to absorb funds especially likely to be spent promptly if they remained in the possession of workers. The amount of any increase could, however, be deducted in full from wages, thus removing that difference also. With the need, set forth in Chapter 3, of reaching the great excess of current income above feasible spending in the middle group of incomes, those from $1,750 to $10,000, by taxes or public borrowing, the advantage of such an adjustment of these burdens is apparent; for these taxes would clearly reach the incomes in at least the lower portion of that group. Moreover, the amount not shifted to the worker would reduce the civilian spending power in the possession of the employer.

The third difference is in the after effects of these taxes. The income tax gives the taxpayer no claim on the government. Social security taxes, on the other hand, leave the government with an obligation to distribute future benefits.[9]

Where, as in the instance of the old age annuity and unemployment insurance taxes, increased benefits are to be expected anyhow in the not distant future, their provision at present is to be welcomed, *if accompanied by a corresponding advance in rates of taxation.* In such a situation, the mere fact that the addition to present revenues entails an equivalent outgo in the form of future payments cannot be counted against social security taxes as a method of absorbing purchasing power. But when social security taxes involve a commitment not otherwise expected either to a permanent schedule of benefits or to a temporary postwar settlement, the income tax has the advantage that the government is left without obligation at the close of the war and accordingly is free to implement any financial policies which seem appropriate in the postwar circumstances.

As between more use of social security taxation as qualified in the foregoing paragraph and the individual income tax, one is not preferable to the exclusion of the other. The additional revenue that should be obtained from the taxation of money incomes is immense, but all will not be collected. Hence a deficiency of revenue and an excess of spending power are accumulating, and rising prices attest the progress of inflation. Increased revenues from taxes which reach the incomes of wage earners constitute an essential element of any financial program that can be expected to absorb the essential amount of spending power. Whether the additional revenue is to be derived from higher social security taxes or higher income taxes depends in considerable degree upon the kinds of burden acceptable to the individuals affected. If at least part is derived from the former, with the implication of increased future benefits, the burden may be more tolerable to the workers than if higher income taxes are relied upon for the entire additional revenue needed. The morale, to use a much-abused term, of workers may be bolstered if at least part of the current levy on their incomes carries with it a promise of return in the future. In these circumstances, additional revenue from both types of tax, as applied to low bracket incomes, is likely to be provided by wartime tax legislation, and the sooner it can be collected, the better. Nevertheless, as noted above, drastic application of both taxes is not practicable. Severe additions to the social security levies would restrict the severity of possible additions to the income taxes on low bracket incomes.

NOTES

1 Since the industrial and occupational coverage differs for the two taxes, the wage base to which the tax applies does also.

2 This figure and supplementary data were computed from information in the Treasury Department *Bulletin,* Sept. 1941, pp. 6-7.

3 The proposal has been made to substitute a single federal system of unemployment compensation for the separate state systems.

4 Hearings Relative to the Social Security Amendments of 1939 before the Committee on Ways and Means, 76th Cong., 2d Sess., I, 61.

5 *How to Pay for the War* (Harcourt, Brace, 1940), p. 46.

6 *Ibid.,* pp. 3 and 46.

7 The aid of unpublished manuscripts by Arthur W. Marget and Eugene E. Oakes is acknowledged.

8 Not all economists would agree, but we believe that the view that places the burden of the tax in the long run on the worker is the better opinion; see James K. Hall, Incidence of Federal Social Security Payroll Taxes, *Quarterly Journal of Economics,* Nov. 1938; also Russell Bauder, Probable Incidence of Social Security Taxes, *American Economic Review,* Sept. 1936.

9 It is, of course, true that states finance unemployment allowances. But in view of the treatment of the funds, this is merely a technicality.