STATEMENT OF J. DOUGLAS BROWN, DIRECTOR INDUSTRIAL RELATIONS SECTION AND PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY, PRINCETON, N. J.

The CHAIRMAN. I understand you are professor of economics at Princeton University?

Mr. BROWN. Yes, sir.

The CHAIRMAN. And that you were on this technical staff that helped to draft this legislation?

Mr. BROWN. I was not on the technical staff, sir, in the sense of the technical advisory board of. which Mr. Leiserson is a member, but rather, I was one of three or four persons that were on what you might call the " full-time staff" connected with the Cabinet committee In my own case, however, I retained my full-time position at Prince: ton and came down in a consultative capacity one or two or more days a week.

The CHAIRMAN. Was this advice more particularly to the old-age pension or unemployment insurance?

Mr. BROWN. It was on old-age security.

The CHAIRMAN. That is what you have specialized in?

Mr. BROWN. Yes, sir.

The CHAIRMAN. All right.; proceed.

Mr. BROWN. I may say in connection with that work that I was associated with Mrs. Barbara Nachtrieb Armstrong, who is professor of law in the University of California, and with Mr. Murray W. Latimer, who is chairman of the Railroad Retirement Board, and that the work continued from last August until the present time. In the course of that time, we not only conferred with the various persons enumerated in the committees advisory to the Cabinet committee, but with many other persons. Also in my own work at Princeton for some years I have been in touch with industry and with trade unions in connection with these problems of pensions and old-age security.

Mr. Chairman, I would be glad to know how much time you would. prefer to have me take? I can adjust-myself to your convenience.

The CHAIRMAN. What is your statement?

Mr. BROWN. I have a' statement here which would take perhaps 20 minutes.

The CHAIRMAN. Very well; you 'will proceed, please.

Senator KING. I think it might be well, Mr. Chairman, to let the doctor finish his statement, and then we can ask questions, if you desire it.

Mr. BROWN. In the development of the old-age security program recommended by the Committee on Economic Security and incorporated in the present bill, every possible principle or method of meeting the problem was considered. Not only were techniques and experience'under public and private programs in this country thoroughly analyzed but techniques and experience in every important foreign country were studied. The recommendations arrived at are the result of the combined thought of a large number of technical experts, business men, labor leaders, and governmental officials—those formally recognized in the committee's report and many others.

The staff technicians who have been most directly engaged in developing these recommendations realize more than anyone else the impossibility of arriving at perfection in the construction of a program of such vast dimensions, no matter what care is esercisecl. A social-insurance program must evolve-not come forth full blown. We feel strongly, however, that this program of old-age security has reached the legislative stage of evolution and, with alterations and adjustments you may deem fit to make within the general framework of the plan, is ready for enactment. The nest stage of evolution is only possible after a permanent social insurance authority is established and operating experience develops. An old-age insurance program requires a generation of experience to perfect,. To postpone the initiation of the operation of the plan likewise postpones not only the attainment of self-reliant security for the aged but the availability of more exact knowledge and experience related to American conditions.

The program arrived at is constructed of three parts:

A. A cooperative Federal-State plan of old-age assistance to those now old and in neecl, or to those becoming old in later years without the advantage of adequate insurance protection.

B. A Federal plnn of compulsory contributory old-age insurance to provide a means whereby employed workers with the help of their employers may insure themselves against dependent old-age and lift themselves through thrift up from the level of dependency on public or private charity in old age.

C. A Federal plan of voluntary old-age annuities to provide self-employed persons such as small shopkeepers and farmers a means whereby they may make secure and economical provision for old age,

While closely related in purpose and effect, these three parts of the general program must be carefully distinguished. The first is old-age relief on the best possible basis-but still relief. It necessarily involves the needs test and normally the limitation of the assistance given to that sufficient for decency and health. The second plan is entirely distinct in operation. It is insurance, not relief. It is contributory and contractual and affords an annuity as a matter of right. It applies to all manual workers and to other employed persons receiving less than $250 a month. The amounts paid to the aged are related to contributions made to the fund, not to need. The third plan is also distinct from the other two. 'While it is insurance like the second plan, it is voluntary not compulsory and is intended to assist self-employed persons not covered under the second plan. The insured person alone contributes under this plan-no employer since there is no employer-and the annuity payable is determined by the number and amount of the contributions paid in..

The first plan is intended primarily to meet the urgent need of persons now old. It will need to' be continued not only for the nest generation while the contributory insurance plan is gaining momentum but after that time as a residual plan-a second lme of defense-to protect those persons who for any reason have not been included a sufficient period under the insurance plan to provide for their old age and who are facing destitution.

The second and third plans complement each other, one covering employed persons, the other self-employed. It seems necessary to have the third plan to assist the provident farmer, small shopkeeper, and housewife to provide for old age in a relatively easy and safe way. With these three plans we believe provision is made for both the present and the future, and for both the wage earner and the self-employed person.

I would like to use my time to explain briefly the reasons why those of us on the staff of the Committee on Economic Security concerned in the formulation of the old-age security program arrived at certain important principles later incorporated in the recommendations and the bill. I shall confine myself to the compulsory old-age insurance plan, the second plan, and that incorporated in title III and title IV of the bill. I will state the main reasons for our recommendations in outline form but shall be glad to elaborate on these reasons if you desire me to do so.

In the first place, the contributory contractual plan uses the method of thrift to protect workers in their old age rather than the needs-test relief which may in time discourage thrift.

Second, it affords a facility for saving for old age which, provided by the Government itself, avoids the dangers of bank failures, of losses on securities and real estate, or of other means of investment or of hoarding.

Senator KING. Pardon me; what title did you say that was?

Mr. BROWN. That is the old-age insurance part which includes the tax provisions in title III and the benefit provisions in title IV.

Third, it makes savings regular and automatic with a return as a matter of right with compound interest in regular installments covering the period of need.

That is the old-age period, from age 65 until the man dies.

Fourth, it avoids the prospect of dependence on children or other relatives (who may themselves be in need) or on public relief subject to a needs test.

Right through this plan we have attempted to provide a means of lifting people out of need in old age by the method of contributory msurance, which is in essence a facility in saving, in which the employer, the employee and the Government contribute to provide an annuity from age 65 until death. We have tried to provide as far as possible that means of protecting people in old age rather than having them go on relief subject to a needs test at 65.

We recommended that contributions be required of workers as well as employers, and I will give you two or three reasons that lead us to that conclusion. In the first place, by contributing? the individual worker establishes an earned contractual right to his annuity through his own thrift.

Second, worker contributions increase greatly the amount of the annuity which can be paid; would in fact double it.

Third, through increasing the amount of the annuities, worker contributions encourage the displacement of superannuated workers and of minor children and women supporting dependent old persons from the labor market, with a resulting increase in wages and earlier promotion.

We have in this country a very serious problem of the American worker, not merely the worker 65 years of age and over, but 45 years and over, and throughout in the studies made by the staff of this committee, we have been looking to means whereby the protection for the older worker under 65 might in some way assist the problem of the worker over 45. We feel that by providing a uniform compulsory retirement method, persons over 65 would be taken out of the labor market. Likewise the employer would be encouraged to take on the man 45 or 50 or 55, and thus to bring additional men into employment in their later years.

I might explain that further this way. Now you have the problem of the person seeking work aged 50 or 55, and the employer realizes that he will soon have the problem at 65 of laying that older man off unless the company has a pension plan. If it has not, it lays him off with no protection. However, if he has a pension plan, it will cost him a considerable amount to take that man on if he is to provide him with an adequate pension at 65. Under the universal pension scheme, the insurance. scheme, that employee throughout life would have been building up his pension so that if unemployed at the age of 50, the employer taking him on at that time, knows that he can lay him off at 65 with an earned pension that will be adequate to take care of him.

Senator HASTINGS. Your bill does not compel him to quit work at 65?

Mr. BROWN. No, sir. Just that the amount of the annuity does not increase because of working after 65.

Then the reasons for employer contribution:

First of all, it provides an automatic method of meeting the depreciation charges on the human factor cooperating in production similar to the usual accounting charges for depreciation of plant and equipment.

Second, it makes uniform throughout industry a minimum cost of providing old-age security and protects the more liberal employer now providing pensions from the competition of the employer who otherwise fires the old person without a pension when superannuated.

It levels up the cost of old-age protection on both the progressive employer and the unprogressive employer. Likewise it spreads the cost of the old-age protection uniformly over the concerns that employ more younger workers. Under the present situation, if a concern is able to employ younger workers and lay them off by constant turn-over in their thirties and forties, in a sense they have no old-age problem. They have shifted it to someone else and to the community. Other concerns which continue their employees until 65 are bearing the cost, because both plant morale within the concern and community morale without will not permit those concerns to lay off those people without pension at 65, so this plan levels the cost between this first concern which has to contribute over against the second concern which has already contributed through its own private plan.

As to Government contributions:

First. To buttress the guaranty of security there must be the financial strength and the taxing power of Government. The final security of any social insurance plan is the guarantee of the Government.

Second. The payment of annuities larger than can be earned in the earlier years of the plan may well be considered a public benefit and has been so considered in practically every important foreign plan. There are limits to the reasonable use of employment and earnings taxes when used for a purpose benefiting the public as a whole.

Third. By Government contributions in the late years of the plan, it is possible to avoid building up large reserves. Throughout our study, we have found that we must face several important variables in this plan. One was to what extent the reserve could be built up and still be kept within manageable limits. The second was the incidence of the tax on the employer, how to adjust that so as to allow business to proceed with the least shock possible. The third was to pay adequate compensation as soon as possible. This one variable of large reserves becomes a factor related to Government contributions. If contribution rates are raised sharply in the early years of the plan, huge reserves accumulate. The problem of investing and liquidating these reserves can be far greater economically than that of a Federal subsidy in later years. If contribution rates are raised sharply in later years, the worker then contributing may receive upon retirement scarcely more than a return of his own contributions, since the employer's contributions will have been used to pay back the amounts expended to supplement earlier annuities.

Fourth. The shifting of the incidence of the employment tax to the consumer, which may take place, may become in time a regressive tax that may well be supplemented by the use of funds drawn from a progressive income tax. The best time to draw upon other taxes would, however, be in the later years of the plan.

In this way the funds accumulating in the early years will be used to pay benefits in the early years; as time goes on and disbursements come closer to meeting the collections, the Federal subsidy could be brought in to make up for those early benefits paid to persons who had been able to contribute but a brief time.

I would like to explain the reasons why the staff group recommend the payment of the larger annuities than are earned in the early years of the plan.

First. To obtain the social and economic advantages of contractual annuities as soon as possible in order to secure the "lift" of self-sufficing and self-respecting old age in our time and not wait until kingdom come to obtain assured economic security for the aged.

Second. To avoid the ridiculously low annuities involved in paying earned annuities only in the early years, which for a time might not warrant the nuisance and collection cost of the tax.

Under the tabulations, a person contributing for 5 years only, with an average wage of $100 a month, would receive 48 cents a month as an earned pension, because interest factors as well as the small contribution rate of 1 percent do not provide an annuity any larger than that on a straight earned basis. Every other important industrial country has paid unearned benefit supplementing that, making it an amount large enough really to assist the person in his old age, and to secure the displacement of superannuated workers from the labor market as soon as possible. That is the third reason.

And fourth, again, to hold down reserves! because if you take in money for all persons aged 20 to age 65, and m your first year of payment you only pay benefits to the one group aged 66, you will see that the income far exceeds the outgo. You accentuate that if the person aged 66 gets 48 cents a month, rather than $15 a month by the payment of an unearned benefit adequate to take care of at least part of his needs. Your disbursements increase faster and avoid the accumulated huge reserve.

Next are the reasons for the maintenance of the lowest reserves compatible with safe operation of the system.

The first thing there is to avoid the undue diversion of funds from the flow of consumer purchasing power, on the one hand, to capital investment on the other. These funds are being taken from a level of income where normally they would be used practically 100 percent in consumer purchasing power. A small amount would be saved but by and large you are taking these contributions from a level of income which would. otherwise be used for consumer purchasing power. If you take those and pile them up in a reserve fund, they have to be used either directly or indirectly in building up capital goods, because they have to be put into something which will make them available at some future time. We feel that to divert an undue part of that consumer purchasing power into capital goods would be economically undesirable.

Second, the accumulation of a large reserve may involve serious complications not only in Federal financing through the necessity of selling and repurchasing Federal obligations in huge amounts at unpropitious times but may affect adversely the capital market. Also large reserves may encourage demand for increased rates of benefit and unwise use of funds for other purposes.

The history of police pensions and of firemen's pensions, and of many other pension funds is that once relatively large reserves are accumulated, the rank and file of the members do not see any reason why the benefits should not be increased. It is very difficult to explain the actuarial principles involved. We were afraid that if large reserves accumulated under the Federal plan, the same problem would arise. Therefore, the recommendation to keep reserves as'low as possible to make the plan a pay-as-you-go plan.

Finally, the accumulation of large reserves may necessitate the reduction of other Federal taxes in order to create new obligations and thus, for a time, relieve the rich through taxes on lower incomes, In other words, we have a pay-roll tax here which, increasing to a larger figure, might require the creation of Federal obligations to invest that fund, In creating those obligations, the Government by so much does not need to finance itself through other, taxes -but can finance itself through bonds, so we may have the paradox of a contribution from workers that might make possible the reduction of taxes on higher incomes.

Next is the gradual' stepping up of contribution rates and the reason for that gradual stepping up of contribution rates. You will notice that it starts at 1 percent 'for 5 years, 2 percent for 5 years, and so. Many people feel that that is a very gradual step up. We felt, however, that there are reasons for a gradual step up.

First, the gradual raising of the rates of contribution softens the impact of the new charge on both the employer who has no pension plan at present and the worker and allows time for readjustments.

Second! to hold down the income into the fund until disbursements are sufficient to avoid the accumulation of large reserves.

Third, a lower initial rate of contribution aids in the enforcement of the tax, since coverage is secured and public support gained while the cost of the tax is small.

We felt that by starting with a l-percent or Z-percent rate, the country could become accustomed to this rate of contribution. At the same time, the fund does not need the money because of the fact that we are retiring so few people on a contributory old-age insurance plan, therefore, we suggest starting with a smaller rate, and after 10 or 12 years when it gets to be a customary charge on industry, gradually adjusting it to the actuarial standards necessary.

Finally, very briefly, as to the enforcement of the tax: It is my feeling that the worker will look upon this plan as in essence a method of saving, with the employer matching his deposits. An interruption in his record reduces the annuity on retirement not merely by the amount of money unpaid but also by the reduction of the number of contribution weeks in his record. Every employed worker by so much has an interest in the enforcement of the tax and in reporting evasion on the part of the unscrupulous employer.

Second, the use of a stamp book, especially in the case of smaller plants, improves enforcement, since each employee can watch his savings accumulate and can note and report omissions.

Third, the employer who evades the tax is not only defrauding the worker of his old-age protection but might be subject to fines and reimbursement of the tax at penalty rates to the credit of the employee.

Fourth, the inclusion of domestic and farm labor while socially desirable will increase the problem of administering the plan at the outset.

These and many other aspects of the proposed contributory insurance program have been carefully considered. The reasons here marshaled are for your consideration. I know that I speak for the technical staff which aided in the development of the recommendations in expressing our desire to be of any help possible to the individual members of your committee or the committee as a whole in your study of the problem of old-age security.

Senator KING. The result of your labors is embodied in the final report which was submitted?

Mr. BROWN. Yes, sir. In this situation I am speaking here as an individual who cooperated with two or three other individuals and whose work, in turn, went through many steps, naturally through the various technical committees to the Cabinet committee itself. I am speaking today as an individual who had the opportunity to cooperate.

Senator HASTINGS. You reached a conclusion, did you not, that at some time the Government itself would have to contribute, out of the general fund, a large sum of money, isn't that correct?

Mr. BROWN. That is my view, sir. My personal view is that in any program of social insurance the final test of security is the financial strength of the Government and its willingness to participate in supporting the plan.

Senator HASTINGS. You did reach a figure, didn't you, that at some time it would cost how much?

Mr. BROWN. In 1980 the figure of the Federal contribution according to one set of calculations that is involving the provisions of the bill is $1,478,000,000.

Senator HASTINGS. Annually?

Mr. BROWN. Annually. The figure I have here is for 1980.

Senator HASTINGS. Would it be apt to increase from there on or decrease?

Mr. BROWN. There probably would be a slight increase relative to that figure. Probably, as I remember, by 1990 it would become stabilized.

Senator HASTINGS. Professor, there is one situation that I worked out which seemed to me might cause some people contributing very much concern. If you take a young man at 20 who begins to contribute in 1937 and he earns $100 a month for 45 years, he will accumulate a fund of something over $4,000, as I recollect it, and will be entitled to be paid the balance of his life $50 a month. On the other hand, a man who is now 45 and who earns the same amount of money pays in for 20 years with the interest compounded at 3 percent; he will have a fund of something like $738 for his benefit, but he will get for the balance of his life $40 a month. I am wondering what the young fellow is going to think about that, and we have got to bear in mind that all of this is legislation that may be changed by the voters whenever they make up their minds that they do not like it. So that the fellow who goes in at 20, with that staring him in the face, may reach the conclusion that that is not fair and he may compel the Congress to change it in some form. That is true, isn't it?

Mr. **BROWN.** The way I feel on that point is this: It is that we are not giving the young man less but we are giving the older man more. And we are giving him' more for a social purpose-that is providing him with a decent income in his old age, despite the fact that the Government had provided no facilities for many years for doing so. You will find, in fact, in practically every industrial pension scheme and every scheme in educational institutions, that when the contributory plan is started, it is necessary to put the older person at some advantage so that he won't reach old age with an inadequate income.

Senator **HASTINGS.** I appreciate that theoretically you may be correct, but you have to bear in mind as one expert has stated here, that there will be 40,000,000 employees subjected to this tax, and there will be 40 000,000 people complaining about it, probably, and I think there will be 40,000,000 people that will be able to vote at the elections, and if they do not like it they can change it; and it seems to me that while you may be absolutely correct theoretically, we are dealing with a democratic form of government with the opportunity in the people to change a particular statute at any time that they can convince the Congress and the President that it ought to be changed. It does not have the stability of an insurance company contract in the respect that it does not have the stability that ari insurance company contract would have. This young fellow who starts out to pay at 20 does not know what Congress is going to change that to, He does not know whether he is going to be taken care of at 65 or not. It all depends on what the Congress does. That is the weakness, it seems to me.

Mr. **BROWN**. I think every scheme of social insurance or every other scheme for the provision of higher standards to the community involves the responsibility of government. Of course, if we should need to look forward to a lack of responsibility of government, perhaps it would be better never to go into any of these schemes, but looking at it from the scientific point of view, once the Government takes upon itself the problem of taking care of its unemployed, its old persons, its sick, it has assumed the position that it will be responsible to those persons who have contributed to the scheme and that when they become old, it will provide them with the annuity toward which they have contributed.

Senator **KING.** Does not the plan contemplate a rather large contribution by the Federal Government, something like one or a half billion in 1980?

Mr. **BROWN.** The plan'as in the bill now involves a contribution on the part of the Government starting at the year 1965 which rises for a 'period and then strikes a plane.' The reason for that is, to offset the payment of so-called "unearned annuities", that is, supplementary annuities, $15 in place of 48 cents in early years. Someone has to pay that naturally, to balance off, and it has been done in practically every other country..

Senator **KING.** What would be the aggregate amount which the Government will have to pay by and including the year 1980?

Mr. **BROWN.'** I am sorry, sir; I do not have that accumulated.

Senator **KING.** It would be several billidn dollars?

Mr. BROWN. Yes. There is one offset, however; that is the fact that you have a saving in that the plan has provided more adequate annuities in early years whereas otherwise you may need to afford relief to those old persons.

Senator **KING.** But there will be a permanent demand upon the Federal Treasury after 1975 or 1980 of approximately 2 billion dollars.

Mr. **BROWN.** It is not that high, sir. The figure I have here is approximately $1,500,000,000 as of 1980.

Senator **KING.** I understood you to say that for. a number of years thereafter the subsidy would be increased.

Mr. **BROWN.** Slightly, but I do not think up to two billion.

Senator **KING.** Before it reached the position of stability?

Mr. **BROWN.** Yes.

Senator **KING.** Can you, with any degree of assurance, state that there will be at some year stability and with no increase?

Mr. **BROWN.** Yes, sir. All of these statistics are based upon certain assumptions, and I would like to emphasize that personally I feel there are definite limitations in planning that far in advance from an actuarial point of view, from an economic point of view, and from a statistical point of view. It is my feeling at least that the important thing is to provide a program which as far as one can tell will meet the situation both from financing and the benefit point of view for some 20 years ahead, and then as time goes on, adjust it. The contribution rate could be increased more rapidly or the increase could be held back as more adequate information is available, so that I do not feel that one can use the figure as precisely as here—$1,478,700,000 or anything like that-with true propriety.

Senator **KING.** I assume that this contribution would come from the Federal Government exclusively, and the State will have no voice in it.

Mr. **BROWN.** That was the proposition, sir.

Senator **BLACK.** Just one question in line with what Senator Hastings asked, because I have evidently misunderstood part of the previous testimony. He asked you about a young man who is contributing more than the older man. I had understood that one of the reasons for that Federal aid was to partially offset this very situation.

Mr. **BROWN.** The fact that the older man receives more?

Senator **BLACK.** Yes.

Mr. **BROWN.** It is.

Senator **BLACK.** Is that not correct?

Mr. **BROWN.** Yes; it is correct.

Senator BLACK. So that instead of the picture being exactly as it was given by Senator Hastings' question, as I understand it, the young man could not be discriminated against, if you call it a discrimination, to that extent, but a part of the difference would be made up by contributions from the Federal Treasury.

Mr. BROWN. Yes, sir. I said that it is not that the younger man gets less. He gets his full share, but that the older man gets more. He gets more because of the Federal subsidy, which as a matter of public benefit takes care of these people in old age.

The CHAIRMAN (Senator King, acting). We will adjourn now until 10 o'clock tomorrow morning.

(Whereupon, at 12:30 p. m., the hearing is adjourned until Saturday, Feb. 2, 1935, at 10 a. m.)