Old-Age and Survivors Insurance for Agricultural and Domestic Workers and the Self-Employed

A report exploring alternative methods of extending coverage to the self-employed and to agricultural and domestic employees was recently published by the Division of Tax Research of the Treasury Department. Because of its pertinence of its subject, the Bulletin is reproducing here the introductory section of the report.

The Social Security Act, approved on August 14, 1935, provided the United States for the first time with a general old-age insurance program and shifted this country from among the more backward to the more advanced countries in the field of social security. Its comprehensive character notwithstanding, the 1935 act provided old-age insurance coverage for only part of the country's population: it left large groups of people outside the program.

The principal groups excluded from the benefits of the old-age insurance program were agricultural workers, domestic service workers, self-employed persons, government employees, employees of educational, religious, and charitable organizations, and persons employed in the railroad industry. In 1946, these categories included about 30 million people and represented approximately 40 percent of the country's paid employment.

The exclusion of the several groups from the program was prompted by different reasons. Railroad employees were covered by a separate system established by the Railroad Retirement Act of 1935. Government employees were excluded partly because some were covered under existing pen-
sion schemes and partly because of legal barriers to the imposition of a Federal tax on State and local governments in their capacity as employers. Less tangible reasons lay behind the exclusion of the employees of educational and other nonprofit organizations.

Agricultural and domestic workers and self-employed persons, now aggregating about 19 million, were not covered principally because the administrative problems in collecting taxes and obtaining proper wage reports were anticipated to be especially difficult. The concept of social security was new to this country, and the introduction of a social insurance program represented a significant departure both for the Federal Government and the American people. In the initial stages of the program, it appeared desirable to restrict old-age insurance to those areas of employment where the prospects for successful operation were best. Moreover, it was anticipated that, as administrative experience was accumulated, noncovered groups could be brought in at some future time without jeopardy to the entire system. It was made abundantly clear at all stages of the discussion that the exclusion of these groups from the initial program was a matter of expediency and in no way implied a permanent denial of the rights of these groups to old-age security on terms identical with those accorded to the covered groups.

In the case of the self-employed, the basis for exclusion was largely administrative in character and related to the problem of collecting taxes from self-employed persons with low incomes. The financial structure of the contributory old-age insurance system adopted in 1935 was built around employer and employee taxes on wages collected at source. It placed primary compliance responsibility on the employer and avoided the need for returns on the part of individual wage earners. This mechanism obviously was not applicable to the self-employed, where employer and employee are one and the same person. The financing of social security benefits for the self-employed had to be built around some alternative structure involving self-reporting by covered persons. The mechanism which held most promise appeared to be an adaptation of the procedures used for income-tax purposes. Since, however, the income tax of those days employed large personal exemptions and was a tax payable by a relatively small segment of the population, its adaptation for social security purposes would have required innovations which were then regarded to involve too much risk. The retention of income-tax exemptions for old-age insurance purposes would, in effect, have entailed the exclusion of precisely those self-employed persons who were most in need of social security protection. The drastic reduction of exemptions or their complete elimination, on the other hand, involved questions of enforcement practicability which were then difficult to appraise.

Another problem which had to be resolved preparatory to the assessment of taxes against the self-employed related to the separation of that part of their income attributable to personal services from the balance due to capital investment. The tax which comprises a contribution for old-age security should apply only to the counterpart of wages—to personal service income which stops when the worker retires and which establishes both the timing and the scale of his retirement benefits. Here again, income-tax experience was relevant and indicated that this type of segregation was fraught with difficulties.

The principal consideration which influenced the decision to delay the coverage of agricultural and domestic workers under the original social security program related principally to the enforcement of social security taxes and adequate wage reports. A lesser problem was the valuation and taxation of income received in kind.

Since, under the program, eligibility for benefits and the size of those benefits were to depend upon earnings, it was essential to obtain a complete and accurate record of the earnings of each agricultural and domestic employee. This required employers to establish and maintain records of each wage payment made to their employees. While some employers were already keeping records of this type, it was believed that most farm operators and particularly housewives would find it burdensome to comply with the requirements, both because of their unfamiliarity with record-keeping and because of the rapid labor turn-over.

During the 10 years of the old-age and survivors insurance system, the need for the expansion of its coverage has frequently received public recognition. In 1938 the Advisory Council on Social Security, established jointly by the Senate Finance Committee and the Social Security Board, recommended in its final report the coverage of most excluded occupations as promptly as possible. This was followed by similar recommendations made by the Social Security Board and the President, just prior to the commencement of the congressional hearings which led to the 1939 amendments of the Social Security Act. That legislation made important revisions in the system but, except for several small groups, failed to broaden the coverage of the program.

Interest in expanded coverage continued. The Social Security Board recommended the enactment of legislation to this end in virtually every one of its annual reports. From time to time the President made similar recommendations to the Congress. In his 1946 budget message and again in 1947, President Truman called attention to the absence of social security protection for large segments of the population particularly in need of old-age security, and suggested legislation to eliminate the existing inequity.

During every session of Congress a number of bills were introduced providing for the extension of coverage either as a separate step or as part of comprehensive social security revision. Notable examples of recent proposals are those sponsored by Senator Wagner, Senator Murray, and Representative Dingell for broad changes in the entire social security program, and by Senator Magnuson to provide a separate retirement program for all those not covered by existing Federal retirement legislation. The legislation pending in this session of Congress is illustrative of the varying approaches to the general problem. Senator Murray's bill (S. 1679) would make extensive revisions in the program, including expanded coverage. Senator Magnuson has reintroduced his bill
The Ways and Means Committee undertook an investigation of various phases of the social security program, including expanded coverage, in 1945-46. Its staff of technical experts (appointed pursuant to H. Res. 204, 79th Cong., 1st sess.), in reporting on this aspect of social security revision, concluded that it was feasible to extend coverage to the self-employed and to agricultural and domestic workers. Following the report of the Technical Staff, the Committee conducted extensive hearings. Virtually every witness who addressed himself to the problem, including representatives of business, labor, farm organizations, Government, and religious, welfare, and educational groups, favored extension of coverage to these categories of workers. In his testimony before the Committee, Commissioner Altmeyer of the Social Security Administration emphasized the need for extending the coverage of old-age and survivors insurance to other groups not now protected by the program.

The present report, which draws heavily on the Treasury Department's experience with the administration of the tax aspects of the social security system, examines the problems of extended coverage and discusses alternative plans for bringing the self-employed and the agricultural and domestic workers into the system. In examining the available alternatives, it appeared desirable to confine detailed consideration to those plans which were consistent with the principal characteristics of the existing social security system. Consequently, some plans which under other circumstances would deserve careful evaluation were not considered.

The present social security program is financed by a pay-roll tax imposed at a rate of 1 percent each on employees and employers. The receipts from this tax have been sufficient to pay the current cost of benefits and to build up a substantial reserve, and are expected to continue to do so for some years to come, notwithstanding anticipated increases in aggregate benefit payments. It is estimated on the basis of a relatively optimistic set of consistent assumptions regarding the long-term operations of the system (high wages, low retirement rates, etc.) that the level cost of the system is about 3 percent of pay rolls. Under a less optimistic set of assumptions, the level cost of the system is estimated at approximately 7 percent of pay rolls. Nevertheless, a combined tax rate of only 2 percent has been continuously in effect since the origin of the program, with the result that the system has been operating at an actuarial deficit, even if the most optimistic set of economic and demographic assumptions underlying the calculations made thus far should materialize. In the absence of an adequate increase in the pay-roll tax, the deficit will presumably be made up from the Government's general fund when the cash benefit obligations of the system warrant it.

This prospective dependence of the system upon some financing from the general fund prescribes in some measure the plans available for the coverage of hitherto uncovered groups. It precludes, for instance, recourse to a plan for voluntary coverage. Under such a plan, those who could best afford to come into the system would do so, while some of those whose need for protection is greatest would not acquire social security coverage. As a result the general fund would tend to subsidize social insurance protection for the benefit of a select group of individuals who need it less than some of those not covered. To safeguard the principle that the Government's general funds serve the purposes of all the population on a fair and equitable basis, it is necessary to limit the choice of plans for the extension of coverage to those which extend protection on the basis of reasonably fair classifications. Voluntary coverage, dependent as it is on the financial position of the insured, would not meet this test. It should also be noted that there are other objections to a voluntary system. For example, it would tend to involve an adverse selection of risk and would thus impose added financial burdens on those who are compulsorily covered by the program.

A further illustration of how the characteristics of the present system restrict the alternative approaches to broader coverage may be cited. From some points of view, there is much to be said for a plan of direct reporting by agricultural and domestic workers themselves by means of an annual return of wages and payment of taxes, similar to that required under the income tax and under a plan discussed (in the report) for self-employed persons. Such a plan would preclude the collection of a tax from the employers of such workers and would involve

(Continued on page 38)
corresponding discrimination between employment in commerce and manufacturing and employment in agriculture and domestic service. It was for these reasons ruled out of consideration.

The plans developed in the report accord closely with the requirements of the existing social security program. They deal only with the tax-collection aspects of the problem. No attempt has been made to develop specific benefit provisions appropriate to the proposed tax plans. Since, however, the plans have been molded as nearly as possible to the present benefit structure and its qualifying provisions, the development of parallel benefit provisions should not present special difficulties.

It should be noted, also, that this analysis of alternative approaches to extending coverage involves necessity a large element of judgment. The advantages claimed for one approach as against another are to a large extent based upon tax-collection experience under different circumstances than those which will prevail when coverage is extended. We have had, for example, extensive experience with the taxation of low incomes. Nevertheless, if in conjunction with a tax on the self-employed with low incomes a program of benefits directly related to that tax were introduced, past experience would not necessarily provide a reliable gauge of the compliance to be expected. The payment of benefits introduces a new factor which may produce more favorable results than those obtained when no quid pro quo was associated with payment of the tax.

On the basis of the studies that have been made, it appears evident that administrative considerations no longer constitute a barrier to expanded coverage. The administrative problems are difficult, as was the case when the existing program was initiated, but given a moderate period of experience and adequate appropriations for the administration of the enlarged area of coverage, they can be resolved. Moreover, tax-collection features and costs are but some of the factors to be considered. Other elements, such as equity among different groups and the possible reduction of public assistance costs which are borne out of general revenues, as well as public attitudes toward social security and other social considerations, also enter into the evaluation process. Whether the old-age and survivors insurance program is to afford protection to segments of the population now deprived of its benefits, is a question of public policy to be determined in the light of these considerations.