Financing Social Security

By Donald C. Rowat

MUCH of the discussion on social security in this country has centred around the argument of social insurance versus social assistance. The result has been to give the impression that the difference between the two is much greater than it actually is and to becloud the real considerations involved in achieving an adequate system of social security. A critical study of the development of these two methods of maintaining income in the last half-century, by indicating that they are merely different approaches toward the same goal, should serve to put discussion on a firmer basis.

Social Assistance

Historically, social or "public" assistance developed first. It was administered locally only to cases of complete destitution, and since all types of poverty were regarded as self-induced, the stigma of charity was attached to its acceptance. The result was that those who could afford to save something out of their earnings but not enough to provide adequate subsistence during periods of not-earning, either were forced to accept the ignominy of an investigation of needs or were left with inadequate income when for any reason they could not work.

About the turn of the century, however, in many countries public assistance saw a new development. Need became categorized, and provision for it transferred to higher levels of government. Pension systems developed with principles of payment entirely different from those of local poor relief. Payments were of a higher standard, allowed a statutory minimum of personal savings, were given almost automatically to applicants who fulfilled certain clearly defined conditions, and did not involve loss of any of the rights of citizenship. In other words, a definite attempt was made to eliminate the impression that acceptance of public assistance was a disgrace. The Australian pension system of 1908, for example, stipulated that pensions to the aged, the permanently disabled, and the blind were "to be granted as a right and not a charity." And as these systems of "social assistance" developed, they became more liberal both in the amount of payment and in the application of the means test.

But there were important reasons why this development was limited. Social assistance represented a direct redistribution of income; yet the prevailing climate of opinion still tended to regard it as unnecessary aid to shiftless paupers. Income tax had not developed to any great extent, nor had the principle of taxation according to ability to pay; great stress was still laid upon the moral obligation of direct payment for benefits received. And the rising proportion of old people in the population produced a rapid growth in the costs of existing pension schemes. The resultant financial limitations meant that only certain categories of need could be provided for by assistance pensions. Cases of unemployment and sickness were often (as in Canada) left completely uncared for except by municipal poor relief. Moreover, existing pension payments were usually inadequate for subsistence and applied only to those nearly or completely destitute, so that the means test still had much of the old stigma of charity.

Social Insurance

Paralleling the development of social assistance, in many countries systems of social insurance grew up whereby wage earners, by paying premiums or "contributions" when they were working, could, with the arising of certain defined eventualities causing the loss of income such as temporary unemployment, sickness, disability and old age, collect "benefits" of stated duration and size according to their previous contributions without the necessity of a needs test. Social insurance differed from commercial

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EDITOR'S NOTE: Mr. Rowat has been doing research on reconstruction and social security for the Economic Advisory Committee and has recently joined the staff of the new Department of National Health and Welfare. The views expressed are entirely those of the author.

insurance in that it was compulsory and therefore could be made to include groups of persons whose "risks" were low without conceding them lowered premiums. It first began in specific occupations and industries and covered only certain social risks, but gradually country after country instituted systems covering additional groups of wage earners and additional causes of need.

But social insurance, because it was insurance, had to assume that low-paid workers could on the average afford to save enough to support themselves and their families when not working. When attempts were made to extend its coverage to wage earners generally, however, this assumption was found to be contrary to actual experience in wage-worker industrial systems.

From the very beginning, therefore, the principle that "benefits" should bear an actuarial relationship to "premiums" could not be strictly adhered to in social insurance. Because its purpose was social, it had to take account of the social adequacy of its benefits and seek to prevent destitution in the largest possible number of cases. And since the lowest paid workers and those with the greatest family responsibilities could least afford the "premiums" yet were the greatest "risks," most of the 25 or more countries with insurance systems of wide coverage had to provide for a substantial supplement in aid of these groups from both employer and state. Insofar as they permitted this limited redistribution of income, then, they were not strictly systems of "insurance" in the actuarial sense.

Yet because of the same financial limitations as were placed upon the state in providing social assistance, the influence of the "insurance" principle upon early contributory systems was necessarily strong. They limited their liabilities by fixing maxium rates of benefit and by reducing their clients to a select group through "qualifying periods;" hence, the lowest paid workers whose contribution were the most intermittent, frequently fell out of insurance altogether and were left to the mercies of public assistance. Moreover, they excluded groups with high incomes and low "risks;" hence, even with a supplement from both employer and state, insurance funds were not able to pay benefits adequate for subsistence to those with low incomes and low risks.

Even where benefits were largely divorced from contributions as in the British old-age and survivors' insurance system instituted in 1925 (where by 1937 the Treasury was paying 60 per cent of total benefits) the state was unprepared, through grants to the "insurance" fund, to effect as large a redistribution of income as was necessary to establish the "social minimum." Though beneficiaries on low incomes were, in part at least, public charges, benefit payments still were too low for adequate subsistence; though insured persons received their benefits as a right, their "right" was of little value if they were to be forced to accept social assistance in any case. The extension of systems of "insurance" to a nation-wide basis, then, seems to have been dictated not so much by the desire to provide income security as a right to a large section of the population as by fear of the rising costs of relief and non-contributory assistance.

True, statemen began to realize that since a man's wages are related to the product of his labour rather than to the size of his family, and since a man's earning power may be lost or interrupted at any time through no fault of his own, poverty in most cases was a concomitant of the wage-worker system of industrialism, rather than the result of individual shiftlessness. And they were coming to admit the responsibility of the state in remedying this condition. Yet they were faced with two seemingly insurmountable problems. The existing state of public opinion was still not prepared for anything like the general redistribution of income that would be necessary for establishing a comprehensive system of income maintenance; and it appeared impossible to collect from the low income groups by ordinary tax-

ation methods even that amount of the total which it would be necessary for them to pay. Hence, the easiest, and politically the most defensible, way of raising funds for at least an improvement in social security systems seemed to be to obtain a very substantial part of the funds from the low income groups by the method of "contributions," supported by the insurance principle. By extending the coverage of social insurance (as in Britain, 1925), or by instituting new systems of insurance (as in the U.S., 1935), governments could persuade contributors to pay for a substantial part of their security benefits, and thus could provide at least a partial system of scial security.

The Lesson of History

From this brief review of the histories of social insurance and social assistance, it can be seen that both have been developing over more than half a century toward more adequate payments and more complete coverage of population and categories of need. Yet both, by the limitations of their development, indicate that achievement of the "social minimum" can be gained only by a further redistribution of income—not only horizontally, from cases of earning to not-earning, but also vertically, from those who on the average can afford to save more than enough to meet life's contingencies to those who cannot. It can also be seen that any contributory system covering wage earners generally which stresses the principle of insurance can never by itself become the basis for any real system of social security. For though insurance demands that the redistribution of income be horizontal, social adequacy demands that it be vertical. And historically, social "insurance" has been marked by a progressive warping toward social assistance in the sense that it has come more and more to involve a vertical redistribution of income through state grants to "insurance" funds.

But as long as modern social insurance sticks to the "contributory principle" in the Beveridge sense—that each individual pays directly the same contribution for the same rate of benefit and that receipt of benefit must be limited by the fact of contribution—and as long as social assistance sticks to the requirement of a means test, they will never come to mean the same thing. If, however, we accept as axiomatic that real social security cannot be gained unless benefits are paid as a right without an investigation of means, then (to avoid the connotation of the means test) the modern assistance approach must be called the "taxation approach" to social security. And the difference between this and the contributory approach is mainly one of how strictly the principle is adhered to that each individual shall pay directly for his own security benefits. If we are to achieve a complete system of income maintenance, then, we cannot choose between "social insurance" and "social assistance" as such. Our real choice is reduced to a decision between the "contributory" and the "taxation" approach to financing social security.

Britain proposes to rely heavily upon the former; Australia, on the other hand, has definitely decided in favour of the latter. New Zealand, by the social. Security Act of 1938, makes use of what might be called a combination of both. In Canada, however, since there has been a tendency to apply the term "social insurance" to either the contributory or the taxation approach, the importance of the decision has not been made sufficiently clear. The Marsh Report, for example, after indicating that for the year 1940-41 over 33.4 per cent of urban families and 50 per cent of rural families fall below what would be required for an Assistance Minimum, goes on to say that for these groups "the need for insurance techniques to ensure even a maintenance minimum is . . . clearly indicated." Yet it does not make clear whether, and if so how, insurance contributions would be collected from this large group.[1] A brief critical survey of the essentials of the British proposals and of the New

(1) "Report on Social Security for Canada," by Dr. L. C. Marsh, p. 23.

Zealand and Australian systems, then, should do much to help clear up our thinking on this subject.

Insurance in Britain

For Britain, Sir William Beveridge recommends extending the coverage of insurance to the self-employed and to additional categories of need, paying flat-rate benefits adequate for subsistence, and continuing, extending, and increasing the flat-rate contribution (but applying the employer's share only to the employment "risks"). Although the state would pay 50 per cent of the overall Security Budget (and after 20 years as much as 61 par cent), 28 per cent would still be collected from the "contributions" of "insured" persons on the principle that contributions "should be related to the value of the benefits and not to capacity to pay."[2] Last September the British Government announced that they were about to institute a scheme which followed closely these proposals—but with the important exception that benefits would be less than adequate for subsistence.

The chief criticism of such a scheme is that for the lowest income group the payment of flat-rate contributions might reduce their standard of living below a desirable level while they are earning. To this, Sir William's only reply is that "it is difficult . . . to believe that a contribution on the scale imposed would be beyond the powers of any appreciable number of insured persons." This point of view he defends mainly on two grounds: that the capacity of the lower paid workers to pay insurance contributions without entrenching upon resources needed for subsistence will be increased materially by children's allowances, and that on the basis of studies of family budgets, the average actual expenditure now falling wholly or partly within the Plan for Social Security is more than the total social security contribution.[3] It is clear that under such a scheme children's allowances would in many cases be used to pay contributions rather than promote the well-being of children; the state would be giving with one hand and taking away with the other. Moreover, studying family budgets is a rather doubtful way of measuring the capacity of the very low income groups to pay contributions, especially since their "average actual expenditure" may already have been pushed too high by the payment of flat-rate contributions in the existing social insurance system. But even the payment of contributions would not necessarily represent the total cost to persons on low incomes. When the system was introduced, at least part of the cost of the employers' contributions (the remaining 20 per cent of the total) would probably be handed on through lowered wages (or the failure to raise wages), or in the form of higher prices to them as consumers.

The system, moreover, would leave completely uninsured those earning less than £75 a year, and would leave unsolved the problem of collecting contributions from the self-employed and others of working age who could not pay the total or, for that matter, any contribution. A substantial means-test system of social assistance would still be necessary to cover these cases, and it is significant that the British Government Actuary stresses the fact that the number of people not completely covered by insurance can only be conjectured on broad lines.

Security Tax in New Zealand

In New Zealand, on the other hand, social security benefits are in no sense related to the amount or duration of "contributions." Their cost is met mainly by a special social security tax of 5 per cent on the income of all individuals over the age of 16 and of all companies and firms. This is supplemented by a personal "registration fee" of £1 per year payable quarterly by all men 20 years and over and of 5s. per year payable by all women over 16 and young men up to the age of 20, and a payment from the Consolidated Fund raised by ordinary taxation to meet any deficit. Certain

(2) "Social Insurance and Allied Services," by Sir William Beveridge, p. 107.

(3) *op. cit.*, p. 114.

classes of people who obviously are unable to pay the tax or the fee (students, persons on benefit, etc) are specifically exempted, yet remain eligible for benefits. In 1941 the registration fee represented only 4 per cent of the total cost, the special tax 71 per cent, and the grant from the Consolidated Fund 25 per cent.

It will be seen that this system represents an advance over the contributory principle as regards placing the burden where it can best be borne. Moreover, as the costs of the system increase with the annual increase in the number and size of the Universal Superannuation payments, the grant from the Consolidated Fund, raised largely by the personal tax on income, will increase, and the proportional tax will represent a declining proportion of total cost.

It can be argued, however, that a system which collects more than two-thirds of its revenue from a flat percentage tax still places a disproportionately heavy load on the shoulders of those with very low incomes, depending, of course, upon the extent of coverage and the incidence of the remaining tax structure. Most of the benefits, moreover, are paid only after an investigation of means. But the inclusion of a scheme for Universal Superannuation and Health Benefits would seem to indicate that as soon as a more effective system can be worked out for making collections through the progressive income tax, universal benefits for all social contingencies are a distinct possibility. Until then, apparently New Zealand will continue its unique crossing of the contributory and assistance methods.

General Revenue in Australia

In Australia, on the other hand, the decision between the contributory and the taxation approach has been more definite. The Lyons Government in 1939 attempted to fill some of the outstanding gaps in the social security system with the National Health and Pensions Insurance Act, much of which was patterned on the British system. Strong opposition to the scheme soon developed, however, especially on the part of the Labour Party, with the result that it was never put into operation. And early in 1943 the all-party Parliamentary Joint Committee on Social Security reported "that the National Health and Pensions Insurance Bill falls far short of any plan of Social security . . . and this Committee does not favour the principle of national insurance for such a purpose." This view confirmed the Government in its conviction that the contributory principle should be rejected in favour of the "taxation" principle. In July of last year, therefore, the Government established a National Welfare Fund into which the Commonwealth shall pay out of general revenue an annual sum of £30,000,000, or a sum equal to one-fourth of the total collections each year from the income tax on individuals, whichever is less.

The view of the Australian Government is that financing social security from general revenue is socially equitable in that it takes account of both the principle of payment according to ability to pay and of payment for benefits received. For, insofar as revenue is raised by means of direct taxation (graduated income tax, estate duties, etc.), the burden is being distributed in strict accordance with ability to bear it; yet no one escapes entirely, for even those whose incomes are not normally subject to direct tax make their contribution through such indirect taxes as customs, excise and entertainment tax, which enter into the prices of many items in the family budget.

A possible criticism of the Welfare Scheme is that regressive sales taxes may be relied upon heavily to pay security benefits. Another is that at first only certain benefits are chargeable to the Fund; others (unemployment, sickness, and health benefits) will not be added until later; and apparently some (like old-age pensions) will continue to be paid on the basis of a means test.

The Lesson of Foreign Experience

An appraisal of these alternative systems of social security, then, indicates that although the task of eliminating the means test through the taxation approach is by no means easy, the contributory approach, as an alternative, lays too much stress upon the horizontal redistribution of income. Insofar as it recognizes the principle of direct payment for benefits received, it has to assume that those who will be in need of benefits can pay. Those with low incomes either are left outside the pale of social "insurance" or find that their contributions place too heavy a burden upon their incomes while they are earning. From the point of view of the economy as a whole, contributions in reality constitute an earmarked, regressive tax which is made possible politically only because of the current popularity of the idea that there is a moral obligation to pay directly and in full for benefits received. Thus their payment by the low income groups may have a very serious tendency to reduce general levels of comsumption and employment.

In support of the contributory principle, Sir William Beveridge advances two principal arguments. The first is that if there is a contributory scheme with a fund of its own, it is almost impossible for a government to extinguish that scheme. (It might, in all unfairness, be said that this argument is so true that it prevented Sir William from recommending that the insurance approach be thrown overboard in favour of the taxation approach!) He argues that the Fund is sacrosanct in that it is self-contained with defined responsibilities and defined sources of income. In a period of serious economic depression, however, a huge fund may not be any more secure than the direct finances of government. A good example is the German wage earners' insurance system which during the depression of the 'thirties, in order to limit demands upon its Fund, was forced both to increase contributions and decrease benefit payments. And the recent British White Paper on Employment Policy, though recommending a scheme for lowering rates of contribution during periods of cyclical unemployment, admits that if the averge percentage of unemployment proved to be higher than was expected, rates of contribution would have to be raised in order to prevent the Fund from running into a continuing deficit.[4]

Australia's answer to Sir William's argument is therefore this: "The National Welfare Fund has been duly set up by Parliament and is as sacrosanct as . . . the social security fund with which Sir William Beveridge proposes to finance his plan. Every man and woman who pays direct or indirect taxes and contributes his or her labour to the nation's well-being, as opportunity allows, has an indefeasible right to the social security provisions of the National Welfare Scheme. Deprivation of those rights or whittling down the terms of those provisions would be a breach of trust with the whole Australian nation."[5]

Perhaps Sir William's main justification for his support of the contributory principle, however, is that people "can pay and like to pay."[6] We have already cast considerable doubt upon the ability of the low income groups to pay flat-rate contributions. If they "like" to pay contributions for their benefits it is because the stigma of the British Poor Law still sticks tenaciously to any form of social assistance involving a means test, and because they feel that the automatic payment of benefits as a right is completely impossible of attainment by the assistance method. Yet there is nothing inherent in an assistance scheme as such which would prevent the payment of universal benefits without an investigation of needs. Indeed, with modern assistance schemes the complete elimination of the means test has been prevented largely because the middle and

(4) "Employment Policy," May, 1944, p. 31.

(5) From a pamphlet "Social Security and Reconstruction," by the Hon. J. B. Chifley, Minister of Post-War Reconstruction, p. 12.

(6) *op. cit.*, p. 108.

low incomes groups realize that the cost will fall back upon them as taxpayers.

If, then, they could be shown that the taxation approach, backed by adequate funds, can become the basis for an even more effective system of social security than that provided by "insurance", there is no reason why they should not "like", indeed, prefer, to "contribute" through the progressive income tax in accordance with their ability to pay.

This is not to say that income tax would be an easy alternative to indirect taxes or contributions, either from an administrative or a political point of view. It can be argued that present income tax machinery is too ineffective to collect enough to pay adequate benefits without a means test. However, in a country like Canada where no general system of income maintenance has as yet been set up, the contributory approach would mean that some new machinery for collecting "contributions" would have to be worked out in any case. If the principles of the taxation approach are more sound, then, the administrative argument should not be allowed to stand in the way. Instead, our taxation machinery should be extended and improved.

There remains not only the difficulty of working out an adequate system of collection for certain occupational groups, but also the problem of showing the middle and low income groups that social security cannot be paid for simply by a more steeply graduated tax on high incomes after the war. Such a tax might weaken individual incentive and lower national production, and could not by itself begin to pay for a comprehensive system in any case. Those on middle and low incomes must contribute a substantial share of the total cost themselves. Though a direct, graduated tax would be the most equitable way for them to pay this share, they may not be prepared to contribute as much by this method as they must to gain a complete system of income security.

If this should be the case, it might be psychologically valuable to preserve at least the fiction of insurance by having benefits at least nominally related to individual contributions—as with the New Zealand registration fee. It might be easier to persuade both low and high income groups to accept an adequate system of security if this sort of nodding recognition is given to the contributory principle.

Any greater recognition of the principle, however, may cause us to be led astray by a false prophet. Neither means test nor "insurance" contribution can give us real social security and if our determination to achieve this objective is strong enough, then the successful application of the taxation approach must be our ultimate aim.

What Family Allowances Mean to the Maritimes

By F. B. MacKinnon

On July 1, 1945, the Family Allowances Act of Canada will take effect and a monthly cash allowance will be paid to every child in Canada under the age of 16 years. It is estimated that these payments will be made on behalf of approximately 3,409,000 children at an approximate cost of $200,000,000 a year

It is the purpose of this article to discuss the Family Allowance Act as it may affect the social and economic life of the Maritime Provinces. What are the implications within the socio-economic framework of the Maritimes? The general arguments for and against the plan have been so well stated in numerous articles and papers during the past two or three years that there is not much more to be added to the discussion.

EDITOR'S NOTE: F. B. MacKinnon is a graduate of Mt. Allison University and did post-graduate work at Chicago and Harvard. He has been with the N. S. Department of Health and Public Welfare since 1939 and has recently been appointed Director of Child Welfare.