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OLD AGE INCOME ASSURANCE: AN OUTLINE OF ISSUES AND ALTERNATIVES

MATERIALS PREPARED BY THE COMMITTEE STAFF

FOR THE

SUBCOMMITTEE ON FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
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LETTERS OF TRANSMITTAL

NOVEMBER 4, 1966.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the members of the Joint Economic Committee and other Members of Congress is a staff document prepared for the Subcommittee on Fiscal Policy entitled "Old-Age Income Assurance: An Outline of Issues and Alternatives."

The views expressed in this document do not necessarily represent the views of members of the committee or the committee staff, but are statements of issues and alternatives intended to provide a focus for hearings and debate.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

NOVEMBER 2, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a staff document intended to form the basis for discussion in the Subcommittee on Fiscal Policy entitled "Old-Age Income Assurance: An Outline of Issues and Alternatives."

This document has been prepared in the main by Dr. Nelson McClung, staff economist specializing in fiscal policy matters, with the assistance and suggestions from all members of the committee's professional staff. As the executive director's letter indicates, it is not a statement of conclusions or recommendations by the staff, but an outline drawn from the literature, intended to provoke debate of the issues and alternatives in this field. Just as it should not be viewed as expressing any views or conclusions of the committee staff, neither should it be viewed as an expression of views of the subcommittee or individual members.

We hope it will be provocative, serving to elicit statements of positions from various experts and interested parties before our investigation is completed. If so, it will have served a very useful purpose.

MARTHA W. GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy.

OCTOBER 31, 1966.

Hon. MARTHA W. GRIFFITHS,
Chairman, Subcommittee on Fiscal Policy,
Joint Economic Committee, U.S. Congress, Washington, D.C.

DEAR MADAM CHAIRMAN: I transmit attached a draft document entitled "Old-Age Income Assurance: An Outline of Issues and Alternatives." This document was prepared at your request as a means of assisting in promoting a useful debate concerning existing and possible future programs for old-age income assurance. As such, it is intended to promote debate in two directions: first, it is hoped that circulation of this document to interested parties and experts will elicit comments and argument that will clarify the statement of issues and alternatives itself. In a word, we should come to a better understanding of the issues and alternatives in the field of old-age income assurance as a whole. Second, it is hoped that the outline will promote the preparation of papers for a compendium covering various aspects of the field to lay the groundwork for later hearings by the Subcommittee on Fiscal Policy under your chairmanship.

In submitting this document, I wish to make it clear that it is intended to arouse a discussion of issues and alternatives, not to provide answers. It has been deliberately framed with the idea of posing issues and discussing alternatives in such language as would provoke argumentation and clarification for the benefit of the committee.

I believe this document should serve a useful purpose because it not only poses the issues and alternatives in this area of old age income assurance in a way helpful to debate, but also for the first time makes clear that a large number of these different programs are in fact component parts of an overall system. It therefore poses for the first time, as far as I know, the basic challenge to all concerned with any aspect of these problems to view each separate program as part of such a system with all that such a systemwide analysis implies. If the subcommittee can obtain papers and testimony viewing these problems from a systemwide standpoint, it will indeed have made a distinct contribution to this area of public and private policy.

The major work in assembling these materials from the literature was undertaken by Dr. Nelson McClung, staff economist, with criticism and advice from the other members of the professional staff. Nothing herein should be misinterpreted as representing either preliminary or final judgments of the staff or the committee on any matter discussed.

JAMES W. KNOWLES,
Executive Director, Joint Economic Committee.

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OLD-AGE INCOME ASSURANCE: AN OUTLINE OF ISSUES AND ALTERNATIVES

The public objective of old-age income assurance is adequacy of old-age consumption. Many private and government programs contribute to the achievement of this objective. An aged person has several possible sources of purchasing power: Individual earnings, prior saving, personal gifts, private charity, public assistance, and pensions. In addition, he enjoys tax benefits and the benefits from public expenditure programs directed toward his needs. From a public policy viewpoint, these several sources of consumption support are complementary to some extent: persons not having access to one source may be able to provide for their needs from another. At some point, though, sources become substitutes. Because the public interest in old-age income does not extend to assurance to the elderly of an unlimited plane of living, persons better provided for from one source will have less need for another. Thus, these many public and private programs constitute a complex interdependent system for the provision of income in old age.

The following discussion outlines reasons for thinking that the old-age income assurance system is neither fair nor efficient. One may suspect that the cost of the system to the Nation exceeds by a considerable margin its benefits to the aged. Pension programs raise the major questions for policy and it is upon them that we focus attention. May not pension plans in too many instances generate expectations which cannot or will not be fulfilled, interfere unnecessarily with the exercise of free choice in employment and in saving, induce an excessive rate of saving, create enclaves of economic power which are not subject to effective supervision, and hinder the productive deployment of wealth? The outline which follows is intended to make explicit complaints often heard that the old-age income assurance system satisfies public objectives very poorly, that combined benefits under all programs are seldom adequate, the distribution of burdens on the young and benefits to the aged unfair, and the process of making transfers of income from the young to the old productive of much economic mischief.

1. OLD-AGE INCOME ASSURANCE SYSTEM

The old-age income assurance system is a tangle of private and public, of individual and collective efforts, of tax, expenditure, and transfer programs. Three questions which should be asked regarding the old-age income assurance system are: (1) What programs have as one of their major objectives the provision of income in old age? (2) What are old-age income assurance objectives? (3) What is the quantitative significance of component programs in the system of old-age income assurance?

1.1 Income programs

What public and private programs constitute our old-age income assurance system? What are the distinctive features of each? How

many people does each cover? Which ones are amenable to Federal policy? These are questions about income programs which we propose to have answered in detail. The following is but a rough sketch of system programs.

To the extent that people seek to provide for themselves adequate incomes in old age through continued economic activity, a policy of full employment furnishes a basic underlying support for old-age income. Programs for retraining older workers and for adapting jobs to the capabilities of the aged make a more immediate contribution to the income of the aged.

For given income from earnings and from accumulated wealth, favorable tax treatment enables the aged to support a higher consumption standard than they otherwise could. Reductions in the taxes paid by the elderly are substitutes for transfer payments to them. In general, reductions in taxes substitute imperfectly for increases in transfer payments because many aged have no taxable income.

Transfers of income through acts of individual or private collective assistance (charity) perhaps should be considered a part of the system, since they do substitute, even if in a quite unsatisfactory way, for other programs. Where these transfers are to persons outside the family through established transfer plans they commonly enjoy favorable tax treatment, although it is not clear that taxation much affects the volume of such transfers.

Old-Age Assistance, of course, is part of the system, as is Medicare. Medicare provides income in kind, but, in this respect, is not unique. Programs in aid of the aged may support their consumption directly or through grants of income. Some small part of Medicare is financed through payments by the aged and thus entails no transfer from young to old. Old-Age and Survivors Insurance, Old-Age Assistance, and Medicare, being Federal programs, are subject directly to Federal control.

Individual saving for retirement and private collective saving through deferred profit-sharing plans and private and government employee pension plans are part of the system. Private individual saving takes many forms, in few of which is it devoted specifically to provision for old age. Federal influence over private programs is exerted primarily through taxation. Although individual saving out of ordinary income receives favorable tax treatment in some instances—for example, purchase of a residence—saving in the form of unrealized asset appreciation is treated most generously. In any event, earnings on capital accumulated during active years and to some extent consumption of capital in old age, always a potential resource to those who have capital, receive favorable tax treatment.

Pension plan saving is favorably taxed from recognition of its contribution to old-age income assurance. Saving through deferred profit-sharing plans receives more favorable treatment than pension plan saving although its contribution to old-age income assurance is less certain. If withdrawals and borrowing during active years prevent accumulation, or the accumulation at retirement is invested, for example, in business and lost, the objective of income security in old age is lost. Despite the plan, some covered by it will become charges upon Old-Age Assistance and receive double public support. In that case, public support through tax subsidy of deferred profit sharing

accomplishes, if any public purpose, one other than old-age income assurance.

In general, therefore, whether a program is an old-age assurance program or not depends upon its objectives and actual effect. Often it is a matter of degree. For example, to what extent should tax benefits extended to the wealthy aged be considered as satisfying a public old-age income assurance objective? The problem arises from our failure to define clearly the public interest in old-age income assurance. Do we seek to set a minimum standard below which we do not want people to live or is our objective the replacement of some fraction of active earnings? The objective reflected in OASI is income replacement at a declining rate—a smaller percentage is replaced of a large than of a small income. Thus, the OASI benefit schedule is a compromise of floor and replacement objectives. Private plans typically provide for replacement of a proportion of terminal income. Ordinarily, constant percentage replacement of terminal income implies replacement of a percentage of career average income which increases with size of career average income. Unless there is a ceiling on terminal income which may be taken into account in computing the pension benefit, as there is under OASI, percentages of career average income replaced may vary widely, favoring the employee with high career average compensation as compared to the employee with low career average compensation. Does replacement of a rising proportion of career average earnings satisfy a public interest in old-age income assurance? If it does not, some part of employer contributions to typical pension plans should be included in employee income subject to tax.

1.2 Old-age income assurance objectives

In one way or another all public programs designed to support the income of the aged involve an evaluation of the needs of the old relative to those of the young. Retraining older people for jobs suited to their abilities, for example, uses resources which might be applied to training younger workers. However, transfer programs present most forcefully the problem of assessing the worth of income to the aged relative to its worth to the young. Piecemeal efforts to provide for the aged which have more or less consciously tried to recognize the interests of the young have left a heritage of unresolved conflicts in objectives. Should the aged continue economically active or retire? Should merit or need govern eligibility for benefits and the allocations of burdens? Furthermore, since in general private programs of old-age income provision receive preferential tax treatment, tax incentives to develop such programs have tended to become the objective for doing so and there has emerged a conflict between the objectives of income assurance and tax parity of labor with property income. The consequence of confusion about objectives has been the development of a system which possibly is excessively costly with reference to the simple objective of income adequacy.

1.2.1. Work versus retirement

In a full employment economy, the retirement of a worker from the labor force imposes a double burden upon society: There is the loss

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of his output and the cost of his pension. Of course, if he is no longer capable of pursuing his usual trade, the lost output is just that which he could produce in a less strenuous activity. If the activity pursued in old age does not pay a living wage, the cost to society is whatever difference between actual and living wage is replaced. One problem with present programs is that they are constructed as if there were a sharp discontinuity in the curve of age-specific work aptitudes and abilities. Since there is not, why do the programs so radically alter the relative advantage of work versus leisure when a worker passes normal retirement age? Is it not possible that we have allowed the objective of old-age income assurance to become in fact an objective of retirement income assurance and pursued so assiduously this latter objective that we have added substantially to the cost of income assurance?

Of course, much depends upon the fact of our living in an economy which actually offers work to all who present themselves. Offering the aged a relatively less favorable inducement to work perhaps makes some sense in an economy subject to chronic unemployment, which is to say an economy subject to inappropriate fiscal and monetary policies. Arbitrary interferences with the work decision in a full employment economy make us all poorer and do not improve necessarily the circumstances of the aged. Continuous full employment is an essential basic condition to old age, as to general income assurance. Given that, why alter the terms of the work-leisure choice when a person passes some specified age? Why not leave the terms unchanged and, maintaining aggregate demand for labor, even try to create employment opportunities for older workers through redesigning jobs and retraining the workers?

1.2.2. Merit versus means

In a simpler time, the aged and others in need were cared for through a system of intrafamily transfers. The right, for example, of an old person to be cared for was established by membership in an extended family and the amount of care was determined by direct comparison of the needs of the aged member with those of other members of the family. This old-fashioned scheme of income redistribution has gradually broken down. The modern industrial order, by imposing a requirement for a high degree of population mobility, has seriously weakened the obligations of extended kinship. We recognize increasingly that income assurance, if it is to be adequate, requires interfamily transfers.

In a system of interfamily transfers the opportunities are lost which exist in an intrafamily transfer system for direct comparisons of needs. It is necessary to develop criteria for eligibility and rules for determining the amount of benefit which give reasonable assurance that the income of some and their opportunities for its enjoyment and productive use will not be sacrificed unduly to raising the income of others. Under our system of income assurance, the right to an interfamily transfer benefit generally is established by working. In contrast to family needs-related benefits, interfamily benefits are work related: the right to benefits is earned by participation in economic activity and the size of the benefit is proportioned to economic worth as measured by money wages.

The community's commitment to the principle of work-related benefits is very strong. Veterans' pensions are not an exception to the rule but rather a generalization of it. Veterans' pensions merely recognize that right to a pension may be earned in ways other than participation in economic production. So, properly, the principle is one of merit-related benefits. Genuine exceptions to the principle are few and carefully hedged in by qualifications which restrict benefits to those not able to work. Tax benefits, it is true, strain the principle by appearing to make meritorious the fact of being aged with an income.

Unfortunately, private and government plans in general have an inappropriate work test. The test is of service to the industry, company, government, or union from which a person retires. However, from the viewpoint of the public interest in retirement income, it is total service to society which should determine the pension benefit. Yet, a person who is a member of a succession of plans, each with a vesting period longer than his membership in any one, retires with no pension in recognition for his years of service. Even where the rule that the pensions should go to those who have "given their lives to the industry (company, etc.)" does not preclude a mobile worker from earning rights to several pensions, typically the combined pension for all years of service to society is less than if all service had been credited under a single plan.

Thus, the pension depends not upon work but upon accidents of work history and the system discriminates against the worker who voluntarily or involuntarily moves from one plan to another. Of two mobile workers, one may receive several small pensions, the other none at all, and neither receive as large a pension as the immobile worker, althouth the three are of equal value to society. Private and government plans may not be designed intentionally to discriminate against women as compared to men, wage earners as compared to the salaried, the unskilled as compared to the skilled, low-paid as compared to high-paid employees, employees of small as compared to employees of large firms, Negro as compared to white, but, given patterns of turnover, that is the effect. This discrimination serves no public purpose. One may appreciate the interests of unions and managements in using small employer contributions to give present long-tenure workers adequate pensions at the expense of giving short-tenure workers not even a promise. And it is true that if all employees completed their working careers as longtime members of some plan, the injustice would be less apparent. That, however, is not the way the system works and even if it did or were likely to, it would fail to satisfy standards of obvious fairness which should be required of publicly (tax) supported programs.

1.2.3. Taxation of retirement income and savings

Favorable tax treatment of retirement programs may take one or the other of two forms: a reduced effective rate of tax on income received in retirement or a reduced effective rate of tax on income received during active years because some portion is set aside for retirement. The existing scheme of Federal income tax treatment of income receipts and applications, which is relevant to old-age income assurance, includes both types of preferential treatment. In a number of ways the current income of those age 65 and over is ac-

corded preferential tax treatment, and certain forms of saving, which may or may not be used eventually to maintain consumption in old age, are given favorable treatment.

The tax treatment accorded both retirement income and saving for retirement has the double objective of encouraging taxpayers to practice lifetime consumption averaging and of enabling aged taxpayers to maintain a higher level of consumption with a given income than they could otherwise. For taxpayers, the treatment of old-age income is equivalent to a transfer payment from the young to the old. The equivalence holds only for taxpayers, of course; nontaxpayers pay nothing and receive nothing. The treatment of saving for retirement reflects a concept of consumption averaging which is alternative to that implicit in tax-transfer programs, such as OASI. In tax-transfer programs, current period aggregate income is averaged over families by taking from some and giving to others. This may be referred to as family averaging. The concept implicit in the income tax may be referred to as time averaging: a given family averages consumption over the years of its life by taking income from early years and allocating it to later years.

Now if the interest earnings on saving were sufficient to overcome for every family the disutility of foregoing current consumption, there would be no need for preferential tax treatment of saving for retirement nor would there be any need for programs of transfers to the aged. Presumably, all families would make adequate provision for the future. For well-to-do families, interest earnings apparently are an adequate reward for saving and tax subsidies are a gift serving no public old-age income assurance purpose. The gift is twofold. Compensation paid in a form which makes it taxable only at a later time confers upon the recipient an implicit interest earning on taxes deferred. Deferring tax on compensation until retirement, when a person's income typically is subject to lower rates, reduces the total tax on aggregate career earnings. The principal of the twofold gift applies also to deferral of tax on appreciation in the value of assets which are held unsold until retirement and then used to finance consumption.

For families with incomes which are low relative to the numbers to be provided for, one wonders if existing tax incentives to saving are of much significance. Such allocation of income to the acquisition of appreciating assets, such as homes, as they make are undertaken from considerations other than prospective returns, considerations which are sufficient inducement in themselves. Such opportunities as they may have for deferred compensation may not be valued highly. Offered a choice between high current wages and employer pension plan contributions, would not many take the current wages? Of course, they have limited opportunities to make such a choice effective and it may be that it is the specific institutional arrangements for collective saving through pension plans which really account for the fact that very much saving in this form is undertaken.

However, deferred compensation schemes are frequently supported by arguments which amount to a claim that labor income should enjoy loophole parity with property income. And, indeed, the tax treatment of deferred compensation is analogous to that for unrealized asset appreciation. Belief in achieving horizontal equity through opening larger loopholes for underprivileged sources of income may explain much of the support for deferred compensation from the more

highly compensated and the greater proportion which deferred compensation is of large than of small incomes measure their success in securing it. Whatever deferred compensation may achieve in the way of horizontal equity as between large labor and property incomes, it detracts from vertical equity by reducing the progressiveness of the income tax. Just as people with low incomes benefit little from the exclusion from income of unrealized capital gains, they benefit little from deferral of income. Thus, an employer pension contribution of $1, worth up to $3.33 in taxable income to the high-paid executive, is worth perhaps only $1.15 in taxable income to the lowly paid employee. By throwing a few cents to workers, managements can feather their own nests with dollars. It is for this reason that union enthusiasm for employer contributory pension plans is curious and Tax Code requirements that plans not discriminate in favor of the highly paid essentially miss the point.

Now the receipt of preferentially taxed income without further qualification serves no public purpose. Only if deferred compensation plans actually satisfy a public interest in old-age income assurance, or some other public purpose, should employer contributions to such plans receive present tax treatment. No argument can be made for not protecting taxpayers from the diversion to nonpublic purposes of publicly supported plans. Is not the use of these plans to achieve tax parity between labor and property income a perversion of objectives? The several features in the Tax Code favoring saving leave us now with an income tax which falls primarily upon consumption, saving having been largely exempt from taxation. Saving for retirement may have a legitimate claim for preferential tax treatment. But how can we be quite sure that this saving is for retirement and provides no larger a retirement income than is justified by the public interest in old-age income assurance? Further, is there any reason for preferring private collective saving for retirement to private individual saving for the same purpose?

1.3. Distribution of net transfer

This section outlines a procedure for assessing the combined impact of old-age income assurance programs. The objective is to measure the net burden by income class imposed upon the young and the net benefit by income class conferred upon the old. Since the net burden is just the difference between what an income class pays and receives and the net benefit the difference between what it receives and pays, the obvious thing to do is to switch to algebra and refer to net transfers with positive signs for net benefits and negative signs for net burdens.

Many old-age income assurance programs are so obviously current transfers that the point scarcely deserves comment. This is true of private individual and collective assistance and public Old-Age Assistance. That the Old-Age and Survivors Insurance scheme is a current transfer is apparent also. Annual benefits are financed from annual receipts of OASI taxes and interest earnings on the trust fund. Interest on the Federal securities held by the fund is paid out of general revenues. Thus, annual benefits to OASI recipients, whether financed from OASI taxes or interest earnings on the trust fund, are transfers of income from the currently active.

A number of rationalizations have been invented for the purpose of obscuring the implication of a current transfer. One is the social

compact. It is argued that right to benefits is earned by making contributions. However useful this argument may be in political debate it does not alter the simple economic fact of a current transfer. The suggestion that participation in OASI is analogous to the purchase of an annuity is very doubtful. Pension benefits are too loosely related to contributions for the annuity analogy to hold in any meaningful sense. Nor is the program properly insurance. As a consequence of the earned means test, OASI promotes the occurrence of that event against which it "insures," the loss of earned income due to retirement. Should we not recognize OASI for what it is: an acceptance of collective responsibility for the aged?

The principle that pensions are current transfers from the active to the inactive holds good for private and government employee plans, whether these are on a funded or pay-as-you-go basis. Pension plans of any sort are arrangements for transferring from the active to the covered inactive command over current output of the economy. The young surrender purchasing power in order that the old may have more than they otherwise would. This is necessarily so and a fact irrespective of the mechanics of the process for transferring real goods and services to the aged. It is sufficient that they actually receive an income without engaging in productive activity. All who live without working have as counterparts those who work without living, in a sense. One must not lose sight of this elementary truth in the discussion which follows of the mechanics of the transfer.

Only in the exceptional case may private pension plans be regarded as arrangements for deferring compensation. To constitute deferred compensation, employer contributions to a pension plan must satisfy two conditions. First, the right of the employee to ultimate receipt of the compensation must vest at the time the contribution is made and, second, the right may not be lost by the occurrence of any event at all, not even death. Subject to these conditions, employer contributions are a form of contractual saving by the employee. Otherwise, the employer's contribution must be discounted by the employee for various uncertainties so that only a part, often a very small part, may be considered saving. Since employee contributions usually satisfy the conditions, they are properly personal savings. Typically, both employer and employee contributions to deferred profit-sharing plans meet both conditions. If the two conditions are met and take-home pay which employees otherwise would receive is not reduced by the value of employer contributions, the employer contributions strictly are a distribution to employees of the economic rents of the enterprise and not compensation for labor services. Perhaps we should speak of income rather than compensation deferral.

A pension plan receives contributions, lends funds at interest, and pays pensions. Its current receipts, thus, are contributions and interest earnings, from which it pays pension benefits if we abstract from dissaving. A plan is said to be unfunded if current benefits are financed from current contributions. If a plan is funding, contributions plus interest earnings will exceed benefit payments. The excess is plan saving. Unless the two conditions mentioned in the last paragraph are satisfied, the saving is plan saving and not saving by plan members. Contributions to a plan reduce the power of some to spend and payment of benefits increases the power of others to spend. Similarly, in a full employment economy with stable prices

plan saving is a surrender by some of purchasing power and a transfer of that purchasing power to others—households, businesses, and governments. We will explore the implications of saving in an economy not continuously at full employment with stable prices in section 2.2

Because those who contribute to plans spend on current output of the economy less than their income, households, businesses, and governments which borrow from plans can spend in excess of their incomes. For the privilege of spending beyond their means, households, businesses, and governments are willing to pay interest. Over time, interest earnings reduce the aggregate contributions which are required to finance a given aggregate benefit. Thus, funding shifts future benefit costs to the present and, on some very special assumptions, reduces aggregate benefit costs. These assumptions relate to the value of the funds to those who contribute them relative to the interest which the pension trust receives for lending them. Funding a plan may be a more costly way to provide future benefits than not funding; this is to say, funding may or may not be economic. Whether it is or not depends upon who parts with funds in order that plans may be well financed and what alternative uses those people have for funds.

Therefore, we should determine who in fact contributes to pension plans; who actually surrenders command over the output of the economy in order that plans and ultimately plan beneficiaries may have greater command. There are three cases.

(1) *No Shifting.* With a 48 percent corporate tax rate, tax deductibility of employer contributions means that a corporate employer contributes 52 cents and all taxpayers collectively contribute 48 cents of each dollar of contributions received by a fund. Thus, the corporate employer's after-tax net income is reduced by about half his contributions to the plan. The taxpayer share results from the fact that, since the Federal Government has a given expenditure requirement and operates on an approximately balanced budget, revenues lost through permitting employers to deduct pension contributions must be made up by higher tax rates on all taxpayers than would otherwise be necessary. In this case, the corporate share presumably is borne by shareholders and the taxpayer share by taxpayers. The economic cost of the plan may be large or small. To the extent that the plan increases plan saving and reduces corporate saving, the loss to the economy may be substantial. However, if the corporate share goes to reduce dividends, plan saving may be at rates of return almost as high as those which shareholders sacrifice and the pension benefits may entail only a mild downward redistribution of income. Even the taxpayer share may entail only a moderate redistribution of income and sacrifice of investment return.

(2) *Forward Shifting.* Assuming that employers are in reasonable effective competition in product markets, they will pass the entire amount of their contributions forward to consumers through increases in prices. Their before-tax net incomes and tax liabilities will be unchanged by pension plans. If contributions are shifted to consumers, it is consumers and not employers or plan members who finance plan saving and pension payments. Because prices are higher, real consumption by households is reduced and resources are released to produce goods for investment and for consumption by

pensioners. Although its real consumption is reduced, a household, as consumer, acquires no claim upon future output. Thus, the reduction in consumption is not saving, except in the highly artificial sense of Austrian "forced saving," but a transfer to pension plans at possibly high economic cost.

(3) *Backward Shifting.* Only in the event that employer contributions are shifted backward and employee contributions are not shifted forward so that combined contributions are borne by workers covered by pension plans may it be said that active plan members pay the pensions received by retired members and store up funds to relieve their successors of some part of the contributions which they would pay otherwise. In this case, workers accept a current wage which is reduced by the value of contributions and the contributions to the plan properly are a part of their total compensation. Since employer contributions are not included in worker income subject to tax, there is a government revenue loss equal to the tax value to employees of employer contributions. This revenue loss is the value which is usually accepted as the tax subsidy to private and government employee plans. Whether the tax subsidy is the tax value to employees of employer contributions or the tax value to employers of employer contributions, in the case that employers pay contributions out of profits, the existence of a subsidy depends upon the fact of contributions not being shifted to consumers. As plans are now set up, if the cost is borne by workers, there is very likely a substantial upstream redistribution of income from workers with low incomes to those with high incomes and a volume of saving which rates of return on plan funds would not induce workers as individuals to make voluntarily.

It is easier to identify the alternative hypotheses as to who actually contributes to pension plans than to determine which hypothesis is correct. To suppose that employers bear the contributions implies that they have monopoly power but from a benevolent regard for employees and customers choose not to exercise it. That consumers pay the contributions implies that neither firms nor workers have monopoly power. That contributions are a reduction in current wages implies either (a) that workers are unorganized and the supply of labor is inelastic with respect to wages or (b) that workers are organized and voluntarily accept partial payment in contributions to pension plans.

Very likely no one hypothesis is correct in all instances. Thus, contributions may reduce the wages of unorganized employees but not reduce wages of the organized. They may reduce wages of older but not of younger workers. Narrowing wage differentials may be explained by an older worker acceptance of the pension contribution as partial compensation and a younger worker rejection. For the younger worker to reject the contribution as compensation is not unreasonable. Consider a worker deciding whether or not to accept employment with a company which has a plan that vests in 20 years. On the one hand, he must evaluate the probability that he will live, first, 20 years to vesting and, second, to retirement age and actually receive a pension. He must also assign probabilities to the employer, first, continuing in business and, second, continuing the plan. On the other hand, he must estimate the probability that during the next 20 years he will receive a more attractive offer of employment from another company.

To accept a current wage which is reduced by the full amount of the employer's pension contributions, the worker must assign a probability of 1 to the on-the-one-hand events and a probability of 0 to the on-the-other-hand events. He is, therefore, in outlook a particular combination of optimist and pessimist. Moreover, he must accept the prospective earnings on the pension fund as correctly measuring his valuation of present over future certain income. Thus, he is of an exceptionally forethoughtful disposition; one indeed may wonder why he does not provide adequately for his old age through personal saving.

In contrast, it may be quite reasonable for older workers with vesting rights to accept pension contributions as a part of their compensation even though they know that their wages in fact bear the whole of employer contributions, the younger workers paying nothing. Analysis of individual choice, however, is not entirely satisfactory. Union bargaining over wages is initiated by a collective decisionmaking process. Younger workers may be affected by considerations of the desirability of providing for retired workers. All workers may believe that any pensions bargained for are paid for by employers and/or consumers. Thus, the union leadership may not have to offer a wage scale which in effect allows younger workers to avoid any part of the cost of the plan, even though contributions are borne by workers.

In a high employment economy there is very likely considerable forward shifting of pension costs. Whatever the elasticity of aggregate labor supply, the supply to any one firm is perhaps rather elastic and more elastic in a tight labor market. However, aggregate labor supply is a statistical construct without operational significance; it is in the micro world of particular wage bargains that shifting either does or does not take place. Wage bargains are struck between employees or a group of employees and a firm or group of firms and it is these particular elasticities rather than the aggregate elasticity which determine how much of employer and employee contributions is shifted to consumers. If one were pressed very hard for a single assumption about the burden, and we are because we intend to allocate it, would it be unreasonable to assume that pension contributions are paid by consumers?

It is obvious from the preceding discussion that the issues in contribution finance require study. We would say "further study" but the sad fact is that there have been virtually no empirical inquiries into the incidence of contribution burdens. Issues relating to fund earnings are, if anything, in a more unsettled state. Since fund earnings are exempt from tax, there is a revenue loss borne by taxpayers. Depending upon the impact of plan saving on the economy, there may be additional income losses to the Nation and, hence, tax losses to the Treasury. Apart from that issue, interest earnings on the fund reduce the contributions necessary to fund a given level of benefits. In any one year for given benefits schedules, the larger are interest earnings, the lower the amount of contributions required. And this is true whether contributions are actually made by employers, employees, or consumers.

Thus, funding may be said to have value for two reasons: it strengthens the quality of the pension promise and it reduces the contributions cost of pensions. However, as we shall argue later, reinsurance is an

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alternative to funding for purposes of assuring the financial integrity of plans. The case for funding must rest, therefore, on its effect in reducing cost. Does it? Earnings on a fund reduce the amount of contributions required but do they reduce the economic cost of a plan? Suppose that pensions are paid by employers and that employers can invest funds at 15 percent after tax while plans can invest at 5 percent tax free. An employer considering the least costly way to provide future pensions for present employees would have to make substantially higher contributions to a pension plan in order to provide a certain schedule of benefits than he would have to invest in his own business in order to pay those benefits out of current business income as they accrue. Much the same must be true if it is consumers or employees who finance plans, since households borrow at rates of interest ranging from 12 to 30 percent or more. Thus, it is doubtful that earnings on pension funds adequately compensate consumers, taxpayers, businesses, or employees, as the case may be, for their sacrifices of investment and consumption alternatives.

The discussion to this point is intended to serve as a caution in interpretations of a net transfer table which we propose to construct. In its simplest version, this table will resemble a business bookkeeping ledger account. On one side contributions to and interest earnings of OASI and private and government employee pension plans will be shown, along with government and private revenue allocations to programs in aid of the aged. On the uses-of-funds side of the account will be shown pension and other old-age benefits and pension plan saving. Sources and uses of funds are necessarily equal so that the account will balance. The table is not a cost-benefit table as those terms are used by economists. Rather, it is a sources and uses of fund table or a cost-benefit table as the terms are used perhaps by accountants. Nevertheless, with reference to the table, one may make qualitative judgments about economic cost and benefit.

An expansion of the account will show balances of sources and uses by income class. This presentation will reveal the distribution of contributions to OASI, employee pension plans, and so on by income class and the distribution of benefits by income class. It will also show plan saving by income class but, of course, the saving figure is merely a balancing item and does not imply that the saving shown for an income class was actually performed by that class. As we have seen, pension saving is done by plans by and large and not by plan members.

The most detailed version of the table will show sources and uses of funds by income class for, first, those under age 65 and, second, those age 65 and over. This table will exhibit the amounts contributed by young income classes to old income classes under all programs. The distributions of contributions and benefits will suggest to what extent all old-age income programs have a combined incidence which is in accord with equity and suggest alterations in programs which might improve the distribution of old-age income burdens and benefits.

The reason for worrying earlier about who pays the contributions to plans is that we require rules for allocating burdens. On the assumption that consumers pay employer contributions, these would be prorated to income classes using consumption expenditures by income class. Employee contributions could be allocated by number of wage earners or wages in each income class. Taxpayer contribution

would be allocated by Federal income or other appropriate taxes paid by each income class. Our discussion made evident the fact that there is considerable uncertainty as to the correct principles of burden allocation. For this reason, the tables will not reveal the distribution of burdens with great accuracy; however, they will show the distribution of burdens and of benefits with sufficient accuracy to permit a general assessment of the equity of the old-age income assurance system as a whole.

2. PENSION ISSUES

The problems created for public policy by pension plans stem from the delegation of social functions to private organizations (including governments in their capacity as employers). These plans are collective arrangements for redistributing income. In general, income redistribution has been considered a public function, at least where the amount of income to be transferred is large. Private charity, of course, redistributes income but not in large amounts. Insurance is an income redistribution scheme operated by private organizations. The insurance industry, however, managed to satisfy public criteria only after being made subject to government supervision. It may well have been too much to expect that the pension industry would succeed where insurance had failed. In any event, transfer of income through pension plans requires of private organizations the exercise of a sense of social responsibility. The exceedingly gentle efforts to inculcate higher standards through administration of tax code requirements for tax qualification and the Welfare and Pension Plans Disclosure Acts leave much to be desired. But it is not just private plans which fail to meet genuinely public criteria of equity and efficiency; government employee plans in many respects also fail. Failure to effect the transfer of income from young to old with fairness and a minimum of adverse economic effects is a consequence not only of defects in the design of individual plans but of the lack of coordination in the system.

2.1. Employment effects

Four possible employment effects of pension plans have received attention. They are the effects on labor mobility, employment opportunities for older workers, rates of labor force participation, and aggregate employment.

2.1.1. Mobility

It is thought, on the one hand, that pension plans reduce worker mobility by offering an inducement to hold on at least until pension rights vest. There may be an inducement but its strength in shaping behavior is not apparent. One bit of evidence is the frequency with which employees withdraw their own deposits to an employee contributory plan upon termination of employment, thereby forfeiting the employer's deposit. Another is the evident lack of concern among younger employees about the terms of an employer's plan. Lack of concern about the plan is an expression, of course, of a lack of concern about provision for retirement and this is much of the case for not leaving to individual discretion minimum provision for old age. But we cannot have it both ways: either employees value the pension promise or they don't. On the other hand, the Treasury rule, designed to prevent discrimination in favor of highly compensated

employees, that forfeitures may not be used to increase benefits but must go to reduce employer contributions offers employers an inducement to accelerate turnover. Firing an employee just before his pension vests is, however, a crude way to save on pension costs. A more subtle and effective means to the same end is to discriminate in hiring in favor of probable short-tenure employees.

Is it not likely that workers are shortsighted and that explains why their inducement has an apparent small effect on reducing turnover and that employers are restrained if at all from taking advantage of their inducement to increase turnover by the effects of such a policy on worker morale, productivity, and the wages which must be paid to attract new workers? To the extent that the two inducements are effective in influencing behavior, is it not possible that their effects approximately cancel and have no significant net effect on turnover? Nevertheless, whatever the influence of pensions on labor mobility, the effects are associated with long vesting periods and lack of universal coverage. They are, therefore, a feature primarily of the private and Government pension system. There is little reason for supposing that OASI has a significant influence on labor mobility.

2.1.2. Employment opportunities for older workers

By not hiring workers who are likely to remain with the company until pension rights vest, an employer can save on pension costs. Pension contributions net of actuarial gain arising from forfeitures are an employment cost on a par with current money wages and, rationally, employers should be no less sensitive to the one than to the other. The typical longer tenures of older workers means that hiring older workers in preference to younger ones reduces the probability of forfeitures. Unless the productivity of older workers exceeds that of younger workers by the actuarial gain from forfeitures reduced by the additional employment costs associated with higher turnover, employers maximizing profits will not hire older workers. For many positions there may remain a net advantage from the employment of older workers; often, however, it must be the case that an employer will find all of the older workers he requires to fill positions where the net advantage lies with the older workers from the normal survival of workers who started young. After all, the number of positions in which older workers are clearly superior ordinarily must be relatively small.

Other things equal, the probability of a forfeiture is a function of time to vesting, so the prospect that an employer can reduce pension costs by discriminating against older workers depends upon his plan having a long vesting period. Discrimination against older workers from this source could be eliminated by requiring that pension credits vest promptly, say after a reasonable trial period for new employees. Again, the problem is one of private and State and local government plans and not OASI.

2.1.3. Labor force participation

In general, pension promises are analogous to life annuities rather than to annuities certain and benefits are paid only during the life of the beneficiary and possibly that of the surviving spouse and the minority of surviving children. If, in addition, pension payments are conditional upon actual retirement, plans offer an employee a reduced incentive to continue earning and, where the disutility of work is

significant, a net positive incentive to retire. Doubtless, the incentive is ineffective unless the pension or pensions to which he is entitled plus other income are adequate to support a minimum acceptable plane of living. And the tax treatment of the income of the elderly may offset to some degree the incentives to retire which pension plans offer. Nevertheless, to the extent effective, the inducement interferes with the labor force participation decision. The prevalence of retirement conditional pension promises is perhaps primarily a tribute to the persistence of the lump of labor fallacy. This is an argument that there is only so much work to be done, and in this context it is better that it be done by younger workers with children to support than by older workers. But it is not in the public interest for pension plans to try to secure full employment of those in the labor force through artificial incentives to reduced labor force participation. Why should not labor force participation be a free decision and jobs for all who decide to work be assured through appropriate monetary and fiscal policies?

Of course, except for OASI, retirement conditional pension promises do not induce withdrawal from the national labor force but only withdrawal from the labor force of the company, trade, or industry in which a person has been employed. So union support for retirement-conditional pensions cannot be given credit for a concern with the general state of employment. The concern, rather, is with creating opportunities for worker advancement. The effect is that particular companies and unions export their older workers to nonunionized sectors of the economy and to employments not covered by pension plans. Thus, poorly paid employments come to be even more poorly paid and to offer even less opportunity to the unskilled. Drawing their pensions, people retired from private and government employment seek only supplementary income and can afford to work for a compensation which alone will not support a decent standard of living. This is but one of several ways in which the self-proclaimed sense of social responsibility exhibited in private and government plans may be suspected at having a rather narrow parochial concern.

It has been suggested that the retirement conditional pension promise is of value to management in screening out inefficient employees. The point may be made more cogently for an early retirement provision than for a stated-age normal retirement provision. However, selection of personnel for retention or separation is a proper management function unlikely to be performed as well by a routine administrative procedure which retains those below a specified retirement age and separates those over that age. From a management point of view, it would seem that an absence of stated early or normal retirement ages would be most advantageous. Arbitrary retirement ages undoubtedly are inefficient because too frequently low productive workers are kept on too long and high productive workers let go too soon. But were retirement left entirely to management discretion, the worker receiving at whatever age he was retired an actuarially equivalent pension, those retired at early ages might not receive a pension large enough to live on. In the administration of work-related programs of old-age income assurance there is a conflict between productive efficiency and assurance of adequate income in retirement. It is not apparent that existing pension retirement provisions represent the best reconciliation of those competing objectives that is possible.

The conflict suggests that a more flexible approach to income assurance is required and the sooner we can see our way clear to abandoning the principle of categorical assistance and the one-horse-shay concept of aging the better. Basically, should not our concern be to develop and to utilize to the fullest such talents and capabilities as people have? Should not people be encouraged to work and afforded opportunities to do so whatever their age? They benefit from activity and society benefits from having the output of their activity. If from earnings, they cannot support a living standard of decency, the shortfall could be replaced through transfer programs which do not deprive people of self-respect nor perversely affect incentives to work.

2.1.4. Aggregate employment

In effect employer contributions to OASI as well as employer contribution to private pension plans in some instances are taxes on employment. This is so because the contributions are more closely related to numbers employed than to payroll. In the case of OASI, employer contributions are proportionate to payroll up to the maximum wage taken into account in computing credits and proportionate to number of workers employed beyond that point. Thus, contributions by a high-wage employer are a tax on employment, which gives him an incentive when output is increased to overtime working an existing labor force as an alternative to new hires. For this reason OASI financing is inconsistent with monetary and other fiscal policies to promote full employment, although OASI financing may have had a favorable impact on the seasonality of employment. An increase in demand, whether induced by monetary and fiscal policies or general forces of growth, initially will encounter a small employment response. The increase in demand for output must push the costs associated with a more intensive utilization of an existing labor force above the total costs, including additional OASI taxes, of new hires before it starts to generate a proportionate increase in employment. Eliminating the wage ceiling would remove this adverse employment effect of OASI financing and the obstacle which it presents to an efficient full employment policy. However, in view of the inherent inequity of excluding employer pension contributions from employee taxable income, there is much to be said for financing the employer's share of program costs by some other means. The value-added tax has been suggested as a possibility but perhaps a revenue-equivalent increase in corporate income taxes would be better. Pension contributions may offer employers some inducement to substitute capital for labor but there is little agreement on either the strength of the effect or its desirability.

2.2. Financial effects

The financing of pensions raises four questions: What is the necessity for funding? What are the effects on the economy of the saving generated by funding? How does fund management affect economic efficiency? To what extent do pension plans create a contingent Federal liability to fulfill their promises?

2.2.1 Funding requirement

Annual "real" saving through a pension plan is the excess of contributions plus interest earnings over benefit payments; that is, it is the net increase in the value of the pension fund not counting capital gains

and losses. The plan saves, not the members. Except for plans which make an annuity-certain type promise and vest immediately, all that a plan member has is the right, subject to certain conditions, to participate in a collective income transfer system. Beyond his own contributions and possibly the interest earned on them, he has no equity in the fund.

Pension plans, like life insurance companies, save in order to provide for the contingency that contributions will diminish or cease. Such necessity as there is for pension plans to save results not from the fact that the life of an individual is uncertain but from the presumption that the life of the plan is uncertain. To assure that the plan have adequate funds at any time to pay promised benefits throughout the remaining lives of members drawing pensions and of members eligible to draw pensions upon attaining retirement age requires that there be accumulated and maintained always a fund which, allowing for future interest éarnings and deaths, will meet the aggregate liability. This is equivalent to an assumption that the plan is liable to terminate at any time. The assumption is amply justified for plans of firms in industries with high failure rates and even for multiemployer plans in declining industries. But for plans of firms and industries with constant or rising employment to estimate the funding requirement on the assumption of termination certain is to overfund because such plans could meet future benefit obligations from future contributions.

Evidently, there is a problem. Those plans most in need of conservative funding have sponsors who can least afford it and plans with sponsors who can best afford it have no need for funding. And to adopt a rule that plans put off the accumulation of a fund until their sponsors have fallen on evil times clearly would not be reasonable. The fault lies not in the principle that the funding rule should allow for future contributions discounted for uncertainty but in the organization of the pension system. In the case of life insurance, we learned a long time ago that if we were to insure everyone through a single agency with perpetual life, it would not be necessary for this agency to accumulate reserves beyond a nominal transactions balance; annual death benefits could be paid out of annual premium income. The scheme will work at the national level, although if Ireland had been a nation in the last century it would have had some trouble. Very likely it would work at a more decentralized level. The essential requirement is that the plan have a constant or rising membership. Declining membership can be met by progressively raising contribution rates but, the rising ratio of retired to active members as membership declines will make a rapidly contracting plan burdensome. In general, small plans are more likely to suffer declines in membership than are large plans. Being more risky, they should fund according to a more conservative rule.

Treasury rules governing private funding make no attempt to discriminate among plans on the basis of differential plan sponsor life expectancy. Minimum funding under Treasury rules is what is referred to as "interest only" funding. This lower limit on funding, which actually is a Treasury test of the plan permanency, merely prevents the unfunded past service liability from growing. The upper limit on funding seems to be in principle the termination certain rule. In practice, the Treasury appears to accept the pension bargain quite as much as the current wage bargain as a test of the reasonable-

ness of business deductions for employee cost. Perhaps there is little else for it to do. So long as the private (and also Government) pension system is so excessively fragmented, a major problem is assuring that plans are not so inadequately funded that their promises are not worth much. And the Treasury has no authority to promote plan consolidation. However, it is possible to imagine an organization of the pension system which would both greatly strengthen the quality of pension promises, and even for that higher degree of integrity, reduce required pension plan saving to a fraction of that required by the present organization. Apart from plan consolidation, reinsurance would reduce funding requirements. Reinsurance extends to each plan the assurance of continuity enjoyed by all.

2.2.2. Economics of pension saving

The large volume of pension plan saving is to some no source of great concern, it being argued that since saving increases the capital stock we are all better off therefore. The difficulty with this argument is that the premise is false. Saving does not increase the capital stock. Investment increases the capital stock. Given the demand for capital goods, increased saving reduces the rate of interest. A fall in the rate of interest may induce additional investment; again, it may not. The factors which prompt businessmen to invest are diverse or at any rate poorly understood, but there is little evidence that the availability of funds or the rate of interest are of much significance except on occasion in exerting restraint. Were the economy operating at rates of growth which tended chronically to be excessive, there would be a case for devising ways to induce additional saving and a highly fragmented pension system might be as good a way as any. However, the economy is not subject to chronic excess demand; rather, there is a more or less continuing problem of keeping demand adequate. In such circumstances, a high rate of saving does not add to but substracts from the capital stock by depressing demand for output and the motive to invest.

Now pension saving, in contrast to personal and corporate saving, is relatively unresponsive to changes in economic fortune. Pension saving, governed by rules for funding plans, increases rather steadily in good times and bad. It is therefore, a good thing in good times and a bad thing in bad times. Corporate saving especially but also personal saving to a lesser degree are automatically stabilizing. To whatever extent corporate and personal saving are smaller because pension saving is greater, something in the tendency of the economy to stabilize itself through compensating changes in savings rates is lost.

In addition to the possible depressing effect of pension saving on growth and its effect in weakening automatic stabilization, there is another aspect of pension saving which deserves attention. Corporate saving is a very large part of total saving and this fact has been cited frequently as a defect in the economic system. Corporate saving tends to be invested in the firms and industries generating it. In general, plowing back places funds where returns are highest and, when the spread between rates within and without the firm becomes too great, a firm has the alternative of conglomerate diversification, which keeps the funds within the firm but not the industry. Nevertheless, it has been argued that as a matter of principle funds generated by economic activity would be more efficiently invested if their place-

ment were managed by households and financial institutions, which consider presumably the entire spectrum of investment alternatives. It is possible, therefore, that pension saving by allocating funds to more productive rather than less productive investments may raise the average productivity of aggregate annual investment. Perhaps, policy should encourage pension saving and, if there is too much saving, do so at the expense of corporate savings.

The Old-Age and Survivors Insurance program does not contribute to savings; contributions and benefit payments are in approximate annual balance. However, the regressivity of OASI financing has an adverse impact on economic stabilization. Financed even by a proportionate tax, the system would have a significant automatic stabilizing effect because of its size. Financed through a progressive tax, it could have a powerful stabilizing effect.

2.2.3. Fund management

We mentioned earlier the Treasury rule which requires that actuarial gain go to reduce employer contributions. That reference was to an increase in turnover as a source of actuarial gain. Another source of actuarial gain is a rise in the return earned on funds. Thus, employers have an inducement to seek high yields on pension funds in order to keep their contribution rate low. Not all employers are equally sensitive to this consideration. Regulated companies may actually prefer a low yield, since in any event they can count their contributions as expenses but may even be able to include the fund in their rate base. In general, the inducement is proper: funds should be productively utilized. However, the price of high yield is high risk and the plan endangers the pension promise which holds a too risky portfolio. It is not entirely a question of the type of assets held and, in this regard, rules relating to the eligibility of assets for holding by fiduciaries are excessively conservative, if not wrong in principle. A portfolio of assets, each with high variability of capital value, may have less aggregate variability than a portfolio composed of assets each with low variability of capital value. Judgments about the risk associated with a portfolio must be made with reference to the total portfolio and not to the riskiness of particular assets in it. Strictly, this relates to market risk. Default risk, however, may be transformed into the equivalent of market risk through holding appropriate reserves.

What is "economy" in the management of funds depends as always in questions of economics upon a balancing of competing considerations. Given the contribution rate, the pension promise is prejudiced by too low a yield and by too risky a portfolio. Appropriate trade-off between yield and risk is a matter ultimately of business judgment. In general, fiduciaries have an aversion to risk because, while there are no rewards for high earnings, there are severe penalties for losing the corpus. And it is this preference for playing safe that is a strong argument for keeping pension funds in the business that generated them so that they will be utilized by a business management not so given to caution. Very generally speaking, reductions in pension plan funding requirements probably confer upon society a boon in productive efficiency. Transferring these funds to business in general through the intermediation of pension funds means that they will be invested on the average more cautiously than if the transfer had not

taken place. What good does it do, we may ask, to consider all of the alternatives if one consistently chooses safe, low-yield investments? The reduction over several years in the rate of economic growth from this diversion of funds at risk could easily exceed the cost of all pension benefits paid.

2.2.4. Contingent Federal liability

We have stressed the likelihood that pension funds will be managed with an excess of caution. The rate at which pension funds have acquired corporate shares during recent years does not suggest caution. Rather it suggests that pension trustees from an interest in reduced contributions and perhaps from lack of experience in financial management may be putting their plans in a position to suffer a disaster such as that which overtook mutual funds in the early 1930's for much the same reason. Pension plan purchases of corporate shares now, just as mutual fund purchases then, are a primary factor accounting for a chronic excess demand for shares which explains a long, rapid rise in share prices. So long as new funds come into the market for corporate shares in heavy volume, prices will continue to rise, if corporations do not start issuing new shares in greater amounts. When prices are rising, the inflow of funds is assured by the quest for capital gains. In principle, there is no reason why the process of new funds causing higher prices and higher prices inducing the entry of new funds cannot go on forever. But if the volume of new funds coming into the market were to decline for some reason and share prices stabilize, funds seeking capital gains would leave the market, and prices would fall. Additional funds would leave as their owners sought to avoid capital losses. The feast continues so long as guests are arriving; when all are present, they sit down to famine. It is a misfortune that banks and insurance companies, competing for pension funds, have got caught up in this process. Through the exercise of monetary and fiscal policy the economy can be protected from widespread unemployment but not against stock market debacles. There is, therefore, some prospect that much of the value of pension funds may sometime disappear. What will the plans do then—ask the Federal Government to make good their pension promises? Much less then a stock market debacle may be required to trigger a Federal assumption of liability. The failure of one automobile company plan very nearly did it. But why should consumers finance the cost of plans and then as taxpayers pay the pensions?

2.3 Economic power

Insurance has been defined as an arrangement whereby certain people offer to relieve us of concern for the financial circumstances of our survivors in exchange for the power to run our lives and it is because we have not felt altogether comfortable about the bargain struck that we regulate insurance companies. The pension system may be thought of as an institution which for the same price offers us financial security in old age. In this section we consider the conditions which give rise to pension system power and the more obvious manifestations of that power.

2.3.1. Conditions supporting pension system power

Collectively bargained private pension plans perhaps are a fairly explicit acceptance by active union members of the desirability of

caring for the retired. A plan once inaugurated no doubt creates an expectation in some degree on the part of active members that they in turn will be provided for in their retirement. That members look upon employer contributions as deferred compensation is doubtful. The existence of a plan seems not to reduce their personal saving, nor is it clear that active members consider employer contributions as a subtraction from the current earnings which they would receive otherwise. These attitudes are sustained, if not generated, by the tendency of union leaders seeking member support for plans to stress that consumers and taxpayers will pay the pensions. Under such circumstances, a high degree of voluntary participation or at least acquiesence by union members in the plan is to be expected. However, the attitude of younger workers probably is one of indifference, the attitude of older workers one of increasingly earnest insistence as they approach retirement age. If so, at any time a rather small proportion of the membership will have an active interest in the plan and these people may not be in a very strong position to exercise effective oversight.

The attitudes of members of employer-employee contributory plans toward their plans perhaps do not differ greatly from attitudes of members of employer contributory plans toward theirs. Only by a considerable stretch of imagination can participation by workers in employer-employee contributory plans be regarded as voluntary. The high rate of withdrawals of own contributions upon separation from employment suggests that not even a better than 100-percent return on own contributions up to the time of separation and a usually not bad normal saving rate beyond is sufficient for many people to overcome time preference. Given an opportunity at the time of entering upon employment, these people presumably would not elect membership if they had access to an alternative compulsory short-term savings plan. Evidently, members of employer-employee contributory plans who withdraw upon separation or would withdraw if separated do not value employer contributions at anywhere near their objective worth. The employer contributions are not deferred compensation. Given a choice between two employers, one with a plan and the other paying an equivalent amount in higher wages, withdrawers would choose the second employer, other things equal. The choice, of course, is one very few people have, since high current wages and fringes go together.

The apparent lack of interest shown by members in the pension plans to which they belong creates a situation in which those who manage the plans may lack effective supervision. Their immunity from supervision is enhanced by the highly qualified right which a member has in the plan. Laws relating to fiduciaries depend for their enforcement upon there being identifiable beneficiaries with a sufficient legal interest in the property covered by the trust to bring a suit in court. The equity of plan members in the plan is so tenuous that they seldom qualify. Limited right by members to complain reinforced by little interest in doing so assure plan trustees a life of tranquil humanitarianism, if that is their disposition. If they are otherwise disposed, they still have the tranquility.

Lack of adequate supervision by members raises a question about the wisdom of entrusting to private organizations the management of a collective income transfer system. The involuntary nature of membership and the presence of strong third party (consumer and taxpayer) interests are further reason for supposing that the provision

of pensions is inherently a public function. There are, however, three additional social control mechanisms which might effectively supervise the pension system. These we suggest do not now adequately protect the interests of plan members and of society but they could be strengthened. It isn't a matter of all plans being bad because they are not subject to effective social control. Rather, it is a question of minimum standards which assure that the worst plans operate more nearly like the best and that the system of all plans satisfies the public interest in old-age income assurance.

Competition, the first of the three social control mechanisms, exerts some but unfortunately too little influence in setting standards of pension plan performance. At present, effective competition extends scarcely beyond a generally one-time scramble by life insurance companies and banks to bid fund management away from plan trustees. It does not extend to plan administration, since that usually is handled by sponsoring company, union, or government. Competition as a device for limiting discretion, that is economic power, and constraining decisions to conform to the public interest cannot come into play because access to the market is denied by customary arrangements of preemptory provision. Opportunities for the exercise of choice by plan members are too few and too many potential suppliers of annuities are denied an opportunity to offer plan members their services. Much of the discussion of the pension system assumes a unity of interests among managements, unions, plan members, and the public at large. One may be as skeptical of that assumption as Adam Smith was of professions by businessmen to trade for the public good. Both private and government plans provide for their members much after the manner of a feudal lord caring for his serfs. The plans are designed to tie a worker to his employer, and, indeed, were employees bound for life to a single employer, the pension system would work much better than it does.

In general, where control through market processes has not adequately safeguarded the public interest, we have substituted control through political processes, specifically public regulation. And, indeed, a number of regulatory authorities indirectly affect pension plans. We have a complex of governmental apparatus for examining banks in the interest of protecting depositors, for examining life insurance companies to protect policyholders, and for reviewing transactions in securities with a view to protecting securities holders. Regulatory activities of the Federal Reserve, Controller of the Currency, Federal Deposit Insurance Corporation, Securities and Exchange Commission and State insurance and banking commissions may afford pension plan members certain incidental protection. Examination of bank trust departments, for example, assures that funds are managed according to customary fiducial standards. But protection extends to pension interests only insofar as those interests are involved and identical to those other interests with whose protection existing agencies for regulating financial institutions are charged. The Treasury Department through administration of requirements for tax qualification of plans has power to regulate, and Labor Department administration of the Welfare and Pension Plan Disclosure Act exerts an influence in a number of ways on plan performance. It is not obvious that the whole of this cumbersome and uncoordinated ma-

chinery has or can correct patent defects in individual plans and, of course, it can do nothing to rationalize the system.

Unions, through collective bargaining, exercise a degree of public supervision over pension plans. However, the involvement of union officials in the administration of jointly managed plans raises a potential conflict of interest between the union as joint manager of the pension plan and the union as representative of the workers' interests in pensions. If the union is to effectively represent the workers, it should perhaps have no interest in the financial soundness of the pension fund, at least as that is affected by pension payout. It should concentrate solely upon seeing to it that the plans actually pay the pensions which workers have been led to expect. A union should not allow itself ever to be put in the position of trying to justify some actuarial quibble which has resulted in a worker being turned down for a pension. Unions have a job to do representing the workers and the less they become caught up in the chicane of high finance, the better they will do their job. Nevertheless, union supervision of private plans even if successful in protecting the parochial interests of each union membership may fail to adequately protect the interests of all workers, to say nothing of the interests of the whole community. One example of the failure of union supervision to protect the interests of all workers is the willingness which they have shown to bargain for plans with large promised benefits but weak vesting. They have, therefore, been parties to these discriminatory arrangements which in actual practice favor the old company and union male hands at the expense of younger workers and women, the workers upon whom the incidence of high turnover mainly falls. Naturally, we should not expect too much of unions in protecting the general interest; they haven't the power and it isn't really their business. Injury to the general interest arises from circumstances over which unions have little control.

2.3.2. Manifestations of power

Power in pension plans is manifest in three ways: The economy with which plans are administered, the leverage inherent in the management of large funds, and use of the pension promise to influence the behavior of plan members.

There are two aspects of administrative efficiency. Plan efficiency refers to the expense of administering a given plan. System efficiency refers to the aggregate expense of administering the system of all plans. An individual plan is inefficient if its ratio of administrative expense to plan benefit payments is high relative to that for similar plans. The entire system of plans is inefficient if a different organization would reduce aggregate administrative expense per unit of aggregate plan benefit payments. In the case of business firms, there are forces making for efficiency in both respects. An individual firm is constrained by competition from other firms to keep down cost per unit of output. Industry cost will be held down by the tendency for the industry to be organized into firms of efficient size and efficient specialization by function. Neither tendency seems to be much in evidence in the case of pension plans.

Of course, the large number of plans is to some extent a consequence of the industry's youth and mergers of plans are proceeding apace. Still, the present number is certainly out of all proportion to any

reasonable differentiation of plans on the basis of member preferences and objective circumstances. It is hard to avoid the suspicion that little enclaves of economic power are being jealously guarded at the expense of efficiency and, ultimately, the interests of the members. No one knows what is the optimum size of a pension plan. Very likely the most efficient size is quite large, so large that very few if any existing plans are of that size. And each plan is wooed by a swarm of suitors—life insurance companies, banks, actuarial firms, lawyers, accountants, and others. All of this attention, doubtless, is a not insignificant attraction of being a trustee. However, the more plans, the more trustees, the greater the volume of wining and dining, the higher the fees, the smaller the pensions.

Some jointly managed plans are in effect administered by the union and this practice raises again the issue of a possible conflict of interest between the union as plan administrator and as representative of the members. Union administration of multiemployer plans must have significant advantages from a purely cost standpoint. Records kept on workers and contacts maintained with them for general union purposes can at slight additional expense serve plan purposes. But it must require great force of character on the part of union officials to not load the pension plan payroll with helping hands for general union tasks. That the administrative expense ratios of these plans is not high relative to ratios for other plans is not a test of their efficiency. First, it has not been established that the average expense ratio of existing plans is an acceptable standard. Second, the economies inherent in the union-administered plan may suggest a lower ratio.

The second aspect in which economic power manifests itself is in the management of the pension funds. One book on pension plans sees the economic power of pension funds in the accretion to control exercised by banks and insurance companies holding these funds. It is rather more likely that the power resides in the companies which have set up single employer plans and in a less well-defined way in the companies and unions which have set up multiemployer plans. The funds which these organizations have to put out for investment are very large. The power to place the funds with one or another bank or insurance company must enhance the bargaining power of the organization sponsoring the plan when approaching the banks and insurance companies on unrelated financial matters. With the growth of pension funds, banks and insurance companies may have lost power and companies with plans quite probably gained power. Since it is the larger companies which have the single-employer plans, the advantage which they have enjoyed relative to smaller business in financial markets is increased. Smaller employers in multiemployer plans perhaps have not gained a corresponding advantage and employers without plans doubtless have lost out relatively and absolutely. The degree of effective control of the economy by a few large firms may have increased and if so, we must set this off as a cost of providing pensions to a few people who are fortunate enough to live long, continue to enjoy employment in many instances right up to retirement age with the same corporation, and even after retirement refrain from acts, in the words of one plan, "inimical to the interest of any of the companies."

Plan funds have been used to finance mergers, to support the price of employer securities, to provide good, low-cost housing for union

members, to finance business ventures in which plan trustees had an interest, and for other purposes, all of which whether for good or ill suggest that the trustees have more than ordinary discretion in the management of funds and use their discretion to promote causes other than the welfare of the supposed beneficiaries of the fund. No type of plan is free of taint. With respect to supporting the price of employer securities, for example, Federal, State, and local government plans are the worst offenders.

Management of plan finances, whether the plan is funded or unfunded, is one aspect of the quality of the pension promise. There are two other aspects. One is the specific features of the promise. This was referred to earlier. It is a question of when rights vest, stated normal retirement age, and so forth in the light of objective circumstances, such as turnover. The third aspect is the administration of the promise and it is in this that the third manifestation of economic power is evident. Administrative decisions must be made concerning who is to receive a pension, when he is to receive it, what will be the amount of the pension, and other matters. Plans are rarely so simple and the affairs of individuals so uncomplicated that there is not room, if indeed not a necessity, for plan officials to exercise discretion. Since plan officials are beholden only to their own conscience and that doubtless no great resource in all cases, discretion may be exercised in ways which in effect constitute a system of rewards and punishments. Companies and unions through the administration of the pension plan gain additional power to control the behavior of employees and members. Now, the thing that is wrong with noblesse oblige is that it fosters a circumspection in the behavior of its subjects and, in this instance, the necessity for circumspection is apt to be greatest just at those ages when it is most offensive. One of the strongest merits of the Old Age and Survivors Insurance scheme is that all of a member's dealings in connection with his pension rights are with people no one of whom has the slightest interest in affecting his behavior.

What seems quite apparent is that the pension promise for many plan members is what a company or union official tells him it is. The little booklets supplied are not much help in any but routine cases. And we can expect that plans will become more rather than less complicated. However clear and honest the pension promise may appear to actuaries, it is a mystery to those to whom made. And the Treasury Department, which is supposed to administer a requirement that plan trustees inform the members, takes the position that it has discharged its duty when it has determined that notification of plan provisions was given. That plan members do not understand the notification, and cannot therefore take even such limited action as is open to them to protect their interests, is none of the Department's concern. Its responsibility, as it sees it, is to collect the taxes, not to examine pension plan members on the principles of actuarial science. In this, the Treasury is correct; the fault is in the quality of the pension promise made.

3. ALTERNATIVES

The Federal Government has a number of policy levers for achieving that design in old-age income assurance such that distributions of combined burdens and benefits under all programs and system

incidental economic effects satisfy public criteria. (1) Through the tax treatment of employer and employee contributions to plans both private and Government, interest earnings on funds, and benefits, it can encourage some and discourage other arrangements. (2) The Federal Government can affect the combined distribution of burdens and benefits through its tax treatment of the income of the aged, through transfer of income to the aged, and through expenditure programs making provision in kind. (3) In a number of ways, the Federal Government can improve the earnings prospects of the aged. (4) It can regulate the activities of private pension plans. (5) Finally, it can prohibit certain activities by law and impose fines for violations.

3.1 Earning opportunities

The aged now provide a substantial part of their income through earnings. Much more could be done to improve employment opportunities for the aged through full employment policies, worker retraining, and job redesign. A fact of old-age income assurance is that we have more old people, living longer, living better, and working less. The last factor is partially a result of defects in the design of retirement programs. Should not pension programs offer annuities certain or life annuities actuarially adjusted to actual retirement age so as to not reduce incentives to continue active in old age? And why should public assistance impose such a high implicit marginal tax rate on earnings?

3.2. Needs related program

As a nation, we want a basic needs-related program or, at least, we do not want old people to live in abject poverty. This is evident in Old-Age Assistance, in Medicare, and in tax advantages extended to the income of the aged. The trouble with the existing program is that it is neither equitable nor efficient. Study should be given to ways of improving basic assistance to the aged. There are a number of suggestions worth considering. One is to convert the present scheme of exclusions, exemptions, and deductions available to the aged under the tax code and payments under Old-Age Assistance to their equivalents in tax credits with provision for refund of excess credits. Existing exclusions, exemptions, and deductions, in general, are extended to not only the aged poor but also to the wealthy aged, to whom they are worth much more than they are to the poor. There is no basis in equity for imposing higher taxes on the young for the sake of giving tax breaks to the wealthy aged. Certainly no income assurance objective is served. Converting these preferential treatments of income to credits, a higher proportion of the benefits would go to the poor. Converting Old-Age Assistance payments to tax credit equivalents, the provision of income to the aged could be handled through the tax system. In effect, we would have a self-assessed transfer system, just as we now have a self-assessed income tax system. Indeed, the two are merged and the only problems created by the merger are those of developing administrative procedures which continue to be adequate when a larger volume of refunds is paid to a larger number of people.

Merging old-age transfers into the tax system and converting present preferential treatments to credits would have significant advantages in terms of economic efficiency. Presently, under old-age assistance, a person loses $1 in benefits for each dollar of earnings.

This is, in effect, taxation of earnings at a 100-percent marginal rate. High-income people frequently complain that a 70-percent top marginal rate discourages them from working; is it not likely that a 100-percent rate discourages the aged poor? Were present Old-Age Assistance payments made in the form of refunds of excess tax credits, earnings of the aged poor would be taxed at the lower marginal rates of income taxation, 14 or 15 percent. The effect on work incentives would be much less severe than under OAA. Taking into account the additional output of those aged who returned to the labor force, the net aggregate burden on the young of supporting the old might well be less than it now is.

This tax credit suggestion is quite a modest proposal. It gives old people a guaranteed annual income but the guarantee is a very low one. There are several more ambitious proposals. Some of these would extend the guarantee to all people and raise the floor to that income which would support a decent and self-respecting plane of living. The guarantee of income would be achieved in some proposals through negative income taxation and in others through a simple, self-assessed transfer payments system. Of course, a program which assured all people that they would not live in poverty would provide for the aged. Programs providing work-related benefits to the retired aged or unemployed nonaged would be supplementary to the basic income guarantee program so people should be required to include work-related transfer benefits in income for purposes of computing the refunds to which they would be entitled under the negative income tax or for purposes of computing the transfer payments to which they would be entitled under the transfer program. These proposals present many thorny policy and administrative problems. Self-assessment, however, has the merit of no more seriously compromising self-respect than claiming exclusions, exemptions, and deductions on a tax return.

3.3 Basic work-related program

Although there can be scarcely any doubt that a needs-related program in some form for the aged commends general acceptance, there is even less doubt that Americans intend that primary reliance in old-age income assurance be placed on a work-related, earning-related, contributions-related, or merit-related program. Essentially, we favor the income replacement to the income floor principle of income assurance. Our basic work-related program is Old-Age and Survivors Insurance. It has been seriously compromised in attempts to make it satisfy requirements of a needs-related program. If we were to develop a better needs-related program, some of the redistributive features of OASI could be eliminated. Of course, the burden of needs-related benefits could be reduced through improvements in OASI—raising benefits, for example, and recognizing all work as qualifying. Perhaps OASI can never be improved to the point where it supplants entirely the needs-related program for the aged, but more could be done than has been.

There is also the possibility of improving OASI along with OAA or whatever to the point where they satisfy the public interest in old-age income assurance and, as a consequence, eliminating whatever justification there may be for public support of the supplementary work-related program, the subject of the next section. There are two

obstacles to improving OASI benefits: regressive financing and compulsory membership. The two are interdependent. Regressive financing adds to the real cost of the program; however, the financing would not be so regressive were participation voluntary. Of course, were participation completely voluntary, many people would face retirement without adequate benefits. If substantial improvements are to be made in OASI, given compulsory membership, some better way to finance the program must be found. One obvious solution to the problem of regressive financing is to permit people to take all or a part of FICA tax as a credit against income tax. Merely raising significantly or abolishing the maximum on earnings taken into account in computing credits would help since a proportionate tax is better than a regressive one. With respect to compulsory participation, the issue is one easily made too much of. Membership in private plans is compulsory if all employers acceptable to a person have similar plans.

One can imagine a two-tier OASI system, consisting of a basic compulsory plan and a voluntary, supplementary plan. Participation in the basic program by employers and employees including all governments and their employees would be mandatory but the purchase of additional social security credits would be left to employer and employee bargaining. The supplementary plan could be opened to the self-employed, just as the present compulsory plan has been. The supplementary plan might provide several options with respect to size of contributions and corresponding benefits. To reduce the tax inequity of employer contributions, both employers and employees should contribute. In any event, credits could vest immediately with provision for cash settlements in cases where a person had accumulated too few credits to justify the administrative expense of paying a pension. The pension promise could be of an annuity-certain type and any earned means test could be eliminated. Both basic and supplementary plans could be unfunded. Employers with existing private plans could be invited to join the supplementary plan and use present accumulated funds to purchase credits in the social security supplementary plan. With or without this last provision, the social security supplementary plan would take a lot of business away from the private pension industry. It is unlikely that the loss would go unnoticed. However, the supplementary plan might well be opened to small employers without existing plans, following the argument used to justify the rural electrification program that this is business the private industry will never get or doesn't want.

3.4 Supplementary work-related program

If, as seems likely, we are to depend largely upon private business and governmental unit pension plans to supplement benefits under a basic OASI plan, we should require that these plans satisfy public interest criteria for old age assurance as a condition for tax support. The discussion of the issues in section 2 suggests the following as appropriate criteria.

Pension benefits an objective right.—The pension promise made to plan members should be completely objective and fully understandable to people untrained in law or actuarial science. Rights of plan members should be legally enforceable. Because rights are worthless if too costly to enforce, plans might be required to maintain at plan

expense legal staffs to represent plan members in their claims against the plan or a public agency could provide legal representation either free or at a nominal charge to plan members. To assure that members have a sufficient legal interest in the plan to sue on all matters affecting it, employees should contribute and employer contributions should vest after no more than a reasonable probationary period.

Comprehensive coverage.—Over the last two decades mainly, we have developed a scheme of work-related benefits which combines a basic public program (OASI), covering most of the population but providing inadequate benefits, with a supplementary private program providing in many instances adequate benefits but effectively covering relatively few. Nominal private and government employee coverage is large but still scarcely half the labor force. Effective coverage probably is well below half nominal coverage since many for whom contributions are presently being made will never qualify for pensions. If large numbers are not to face retirement with only the OASI benefit, effective supplementary pension coverage must be extended. Moreover, extension of coverage is necessary to avoid the arbitrary inequities of the present system, which relates pension benefits to merit very poorly.

Benefits based on service to society.—This can be approached in one or the other of four ways. (1) Merger of plans. To be fully successful, plan merger would require that all plans merge into one and this plan have unversal coverage. (2) Prompt vesting. Early vesting of pension rights would mean, generally speaking, that combined benefits in retirement were based on career earnings. Mobile workers would receive lower total pensions than immobile workers but they would receive pensions. However, the vesting approach does nothing to reduce system inefficiency, which we referred to in the discussion of issues, arising from the existence of too many plans of too small a size. (3) Transferability of credits. Transferability comes in two models: (a) Portability, the ability of an employee to carry his credits from a predecessor to successor plan, and (b) Starboardability, the payment of contributions by a successor employer into the plan of a predecessor employer. The wide variety in design of plans makes either model (a) or (b) an exceedingly cumbersome mechanism for cumulating credits. Computing actuarial equivalents for specific features of plans in order to determine the value to assign in one plan to contributions made by an employer with another plan would keep an army of actuaries busy. (4) Pension credit clearinghouse. This would be an organization set up to make conversions of credits in one plan into equivalent credits in another and to make appropriate transfers of funds. Like a trading stamp exchange, it would greatly increase the redemption rate for credits. Over time it could simplify its task by promoting plan standardization.

Minimum adequate funding.—Saving done by pension plans should be the least that is necessary to assure that pensions will be paid. This is so for three reasons. First, funding by raising current contributions costs is an impediment to extension of plan coverage. Second, the accumulation of funds poses a continuing threat to maintenance of full employment. Third, the management of pension funds presents a challenge to effective supervision of economic power. Saving could be reduced substantially through reinsurance. This is an arrangement not as sometimes alleged for insuring employers but for insuring pension promises. The reinsurance premium would be

based upon the life expectancy of the plan. Many large single employer and perhaps most multi-employer plans have long life expectancies and reinsurance premiums would be small. On the other hand, premiums for some plans would be equal to the contributions required to fund the plan. One possibility is to offer the high risk plans the opportunity to enter an arrangement such as an OASI supplementary plan mentioned in the previous section and reinsure only low risk plans. The reinsurer could be either a public or private organization. The FDIC is an example of a public organization which insures promises but, of course, not since State banking in the early 19th century have banks made promises comparable to those now made by pension plans. In that instance, it was the bank notes which hopefully would get lost; in this, it is the workers. Reinsurance would have some problems to grapple with, the runaway plant and disappearance of plans through merger, for example.

Effective supervision.—It is unfortunate that more imagination and initiative was not devoted in the early days of pension planning to the development of more competitive forms of organization. Positions having hardened by now, reorganization for competition no longer may be feasible. Nevertheless, suppose that a company having a plan was required for tax qualification of its plan to contract with several life insurance companies, each life insurance company to offer employees of the company an annuity purchase plan with perhaps a high and low option. An employee would be free to elect any one of the contracting life insurance company plans with the provision that, if he changed his election, the old company would transfer reserves accumulated for him to the new company. Provisions could be made also for transfer of reserves where necessary when the employee changed employers. This arrangement would put life insurance companies in continuous competition with each other and preserve freedom of employee choice as to company and, subject possibly to the restriction that he could not opt out altogether, preserve employee freedom to choose between present and future consumption in the option elected. To provide incentives to make a deliberate choice and take a continuing interest in the plan, a worker should be required to contribute from his own income at the same rate as the employer. Not all those offering plans need be life insurance companies but all would be subject presumably to State insurance regulation and this would be an additional advantage of this hypothetical scheme.

There is no good reason, from the standpoint of the public interest in pensions, why plans should be identified with employers or unions. Indeed, there are good reasons for keeping the funds and all aspects of pension administration clearly separate from employer and union. Certainly unions ought to stay out of the business. Completely free from involvement in the administration of plans and funds, they could exercise a more effective supervision.

The alternative to effective supervision by competition and unions is public regulation. A public agency with authority to require reports, to investigate, and to sue in courts on behalf of plan members could enhance the quality of the pension promise. Were such an agency set up, it could also reinsure low-risk plans, offer a plan for small employers and the self-employed, serve as a pension clearinghouse, and certify plans for tax qualification. There would still remain issues of strengthening the design of pension promises with

respect to vesting, retirement, etc. Regulation is, of course, no panacea and it is easy to take an overly sanguine view of its prospects.

Equal tax treatment. Whatever the tax treatment of programs of old-age income assurance that treatment should be the same for all, unless there are clear public purposes to be served by favoring some as compared to other programs. Although we say that we prefer that people make personal provision, personal saving apart from the holding of appreciating assets is taxed more heavily than collective pension plan saving. However, saving through self-employed plans is treated more generously than either. This is so because the person setting up a self-employed plan in effect purchases an annuity certain while the members of a collective plan acquire merely a highly qualified prospect for a life annuity commencing upon retirement. Deferred profit sharing is taxed more lightly than pension plan saving, although its contribution to old-age income assurance is more doubtful. And, since employer contributory plans are more lightly taxed than employer-employee contributory, the private supplementary pension program is favored relative to the public basic program.

In general, present taxation of labor income earned in old age possibly offers less discouragement to effort than the taxation of labor income earned when young. The effect doubtless is quite mild because the favoritism shown the income of the aged affects primarily the average and not the marginal rate of tax. However, the combined effect of taxing earnings under the income tax, exempting OASI benefits from income tax, and reducing benefits for earnings according to a three-bracket progressive rate schedule of zero, 50, and 100 percent must have a powerful impact on work incentives. If, as suggested, employee contributions to OASI be allowed as credits against income tax, then benefits received in old age should be fully taxed. The earned means test clearly has little justification in a full employment economy. Removing the means test and taxing benefits would leave the aged with about the same after-tax income incentives to work that the young have. And in general there would seem to be little reason for taxing the income of the aged differently from that of the young. The problem to which policy should address itself is one of low incomes and large expenditure requirements but this is a problem by no means peculiar to the aged and one best dealt with by general measures.

Categorical taxation, like categorical public assistance, is faulty in principle. Just as we would do well to abandon the category of aged for tax purposes we would gain from an elimination of the category of nonprofit organizations, among which are pension plans. The receipt of income is an economic activity. Applying a general rule that all income received by any person or organization is subject to taxation, outlays by any person or organization in the support of activities of a genuinely public character would be recognized as deductions in computation of tax. Applied to pension plans, this principle of taxation would give the Federal Government the ability to discriminate finely between activities in the public and those not in the public interest. For example, it could set an upper limit on the deductibility of pension payments to any one individual.

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