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OLD AGE INCOME ASSURANCE

A COMPENDIUM OF PAPERS ON PROBLEMS AND POLICY ISSUES IN THE PUBLIC AND PRIVATE PENSION SYSTEM

SUBMITTED TO THE

SUBCOMMITTEE ON FISCAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

Part I: General Policy Guidelines

DECEMBER 1967

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LETTERS OF TRANSMITTAL

DECEMBER 4, 1967.

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 part I, "General Policy Guidelines," of the compendium of papers entitled "Old Age Income Assurance," prepared for the Subcommittee on Fiscal Policy.

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.

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

DECEMBER 4, 1967.

Hon. WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is part I, "General Policy Guidelines," of the compendium of papers on problems and policy issues in the public and private pension system, entitled "Old Age Income Assurance."

Part I considers the political and social issues in retirement income policy and contains 13 papers contributed by invited specialists.

The subcommittee is indebted to these authors for their excellent contributions, which we believe will add much to a general awareness of the issues in retirement income policy, particularly as these relate to old-age and survivors insurance and tax programs. The time and learning devoted to the preparation of these papers should do much to stimulate interest and to assist in policy decisions concerning future programs for old-age income assurance.

Dr. Nelson McClung, consultant to the subcommittee, is responsible for the planning and preparation of the compendium, with the editorial assistance of Anne McAfee, and the advice and suggestions of other members of the committee's professional staff.

As the executive director's letter indicates, the compendium should not be viewed as an expression of views or conclusions of the committee staff, nor should it be viewed as an expression of views of the subcommittee or individual members.

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

DECEMBER 1, 1967.

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

DEAR MADAM CHAIRMAN: Transmitted herewith is part I, "General Policy Guidelines," of the compendium of papers entitled "Old Age Income Assurance." This study was prepared at your request in order to bring together current thinking on the questions of retirement income programs and thereby contribute to policy decisions by focusing attention on the more promising solutions of the income problems of older people.

The compendium, which is being issued in five parts, confirms the fact that programs to aid older people have grown in number, size, and complexity, and that the coordination of these programs and their combined impact on the income of older people have received too little attention. Clearly, public policy issues exist with respect to coordination of these programs, appraising their effects on the economy, and improving equity.

Part I contains contributions by the authors listed below. The committee is indebted to these contributors who have given generously of their time and expertise to provide the latest available information and competent analytical perspective on this important subject.

Mr. Robert M. Ball
Prof. Merton C. Bernstein
Mr. Pearl E. Charlet
Mr. Roger Fleming
Mr. Marion B. Folsom
Prof. Byron L. Johnson
Dr. John McConnell
Mr. Andrew A. Melgard
Mr. James F. Oates, Jr.
Mr. Charles A. Siegfried
National Association of Manufacturers
Mr. Robert Tilove
New York Life Insurance Co.

The major work in planning and compiling this compendium was undertaken by Dr. Nelson McClung, consultant to the subcommittee, with the advice and suggestions of other members of the staff. He was assisted in the editorial work by Anne McAfee. Nothing herein should be interpreted as representing either the opinions of the staff or the members of the committee on any of the matters discussed.

JOHN R. STARK,
Executive Director, Joint Economic Committee.

OLD AGE INCOME ASSURANCE

Part I: General Policy Guidelines

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PENSION, PRODUCTIVITY, FREEDOM, AND SECURITY

BY BYRON L. JOHNSON*

SOME CONFLICTS IN POLICY LONG OVERDUE FOR BETTER ANSWERS

The United States is deep into the third phase of its experience with provision of income assurance to the aged. This new phase, of private pensions programs, poses very serious questions of policy deserving the most thoughtful consideration. This paper reviews some key questions, identifies some policy conflicts, and suggests possible courses of action for a fourth phase, which needs prompt attention.

The first phase—

Starting in 1935 (and ignoring the very modest public and private pensions already in existence) during the first 15 years (or until 1950) the primary support for the aged was, in fact, old age assistance.

The second phase—(OASI now OASDHI)

The 1950 amendments turned attention from the old age pension to the social insurance program; and in the past 17 years this transformation has been profoundly significant. Today 22.5 million persons are drawing OASDHI benefits, of whom 16 million are elderly. Benefits are averaging just under $90 per month. By contrast, only 2 million of the elderly, including 1 million of those also drawing insurance benefits, are now dependent upon old age assistance, and receive an average of less than $70 per month. Put it another way, 80 percent of the elderly are now primarily dependent upon social security; another 5 percent draw welfare payments which supplement their social security; another 5 percent of the elderly must still rely almost entirely upon the Welfare Administration's old age assistance payments; and the other 10 percent are still actively employed and rely on employment for their income.

The third phase—

Private pension plans have been moving rapidly forward. Today, some 50,000 plans nominally cover at least 28 million workers. Although one-third of the labor force are now under some private retirement plan, only 15 percent of those over 65 are drawing pensions or are wives of those drawing pensions under such plans. Before World War II, in 1940, only 4 million workers were covered by such plans and the pension funds totaled only $2.4 billion. Today these funds exceed $134 billion and they are expected to grow beyond $200 billion well before 1980.

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This rapidly emerging third phase in the field of old age income assurance warrants every serious public examination and discussion. Serious questions have been raised, as by Father Paul Harbrecht, S.J., in his book, *Pension Funds and Economic Power*, written for the 20th Century Fund, published in 1959; by Merton C. Bernstein, in his book, *The Future of Private Pensions*, published in 1964; and in various congressional hearings. This symposium offers yet another opportunity for bringing to public attention some of the very searching questions that have not been fully examined by industry, by labor, or by the Government. Let's look at some of the questions:

A. Can Pensions Protect Both Freedom and Security?

Shall the retirement system increase freedom while increasing security or sacrifice freedom in order to increase security?

One of the original reasons for adopting a nationwide program of old-age benefits was to assure the worker that his rights would follow him in every covered employment and that he would be fully protected. The intent of the law was to provide him with security while underwriting his freedom.

Ten years later, the Employment Act of 1946 declared it the intent of Congress to promote and maintain maximum employment, production, and purchasing power. Obviously the intent of Congress requires that each worker be enabled and encouraged continuously to seek and to accept that position, that job in that industry where he might make his own maximum productive contribution, even though it may mean a change in employments.

Unhappily this has been somewhat inhibited by the widespread growth of private pension plans. Many reasons have been given for this rapid growth. In part, it may have been the failure to provide more nearly adequate social security pensions before the 1950 amendments. Certainly these helped encourage such early major programs as the Krug-Lewis agreement covering the United Mine Workers. In part, it grows out of the willingness during the war years to permit employers to spend money for fringe benefits outside the guideposts of the wartime stabilization program, but not for salaries or wages. In part, the generous provision of the Federal income tax treatment of contributions into retirement funds has stimulated their use. In part, it was encouraged by the unions' response to the *Inland Steel* decision in 1950, that pensions were a proper issue for collective bargaining.

The hard fact is that half of the 28 million workers who believe they are covered are likely to find that the time spent will not cover them because the plans are inadequately vested and because American workers do change their jobs. Unless the plan provides for vesting and unless the worker stays with the employer long enough to earn a vested right, he will find that when he exercises his freedom to change jobs, he loses either all of his retirement security or that portion which is not fully vested. Some plans do require employee contributions and they do provide a refund of the employee contribution. But this helps little because the bulk of the funds are provided by employer contributions. Thus the net effect of the private pension plans is either to reduce the mobility of workers and thus inhibit maximum

production rather than promote it, *or*, to the extent that the workers exercise their freedom in order to maximize their contribution to productivity, the plans cause workers to reduce or abandon their security.

These general principles take on flesh and blood only when one thinks in terms of specific cases. Among the cases that early attracted my concern were many such as the following:

Case 1: A worker, with 23 years of service, approaching retirement, whose wife's health made a move mandatory—but vesting occurred only after 25 years. To meet vital family needs and use his freedom, he and his wife lost their security. Therefore he launched a small business with his personal assets, and lost most of these.

Case 2: A worker under an industrial plan was reassigned, during a labor shortage, from a desk to a road job, completely outside his background, with bad hours and worse meals. To protect his pension, he accepted the transfer rather than seek suitable employment outside the plan. The new duties weakened him, leading to untimely death. Protecting his security cost him his freedom, and shortened his life.

Case 3: A worker who wanted his freedom delayed taking it for several years, protecting his security. When he finally had what he thought was a vested right, and quit to go into business for himself, he found that he could only withdraw what he himself had put in, far less than the amounts set aside "for him" by the employer. The security was more illusory than real, when he exercised his freedom.

Case 4: A professional man covered by a State employees' system could not transfer to other larger schools in the same State, operating under different retirement systems, nor could he leave the State, without abandoning much of his security. His career advancement was sacrificed on the altar of security, because the system would not protect both.

Case 5: A widow, seeking a new career in later years, found her normal employment opportunities largely blocked because these were mostly covered by retirement systems that discourage hiring older workers.

The Nation has a great interest in assuring that the old age income protection methods encourage each worker to make his own maximum contribution to production. But the national policy with respect to private pension plans discourages what is obviously in the national interest.

Similarly, the national interest is not served by discouraging the worker from making his maximum contribution. It is unfair to force him either to buy greater old age security at the expense of his freedom, or to abandon a portion of his old age security in order to regain his freedom. The rapid rise in the number of private pension plans and the sharp limitations upon their vesting have woven a net which has trapped an increasing number of workers as the years go by. Those who have discovered the trap are coming to resent it.

We can organize old age income assurance to *provide greater security while expanding freedom, but we have not fully done so.* Must this become a public scandal before action is taken? Or can reasonable men, seeing the consequences of their previous action, take corrective action? This is the first question facing the Congress.

B. Are We Meeting the Changing Purposes of Pensions?

The Congress decides which of the various purposes it will serve, and how fully. From the outset existing law has tended to stress minimum protection together with some reward roughly related to the past productive contribution of the worker. This reward is increasingly being geared to productivity in the more recent past.

But pensions have also been designed to provide retired persons with an equitable share in the growing output. Some other countries are already using productivity increments to provide retired persons with their proportionate share in the improvements of productivity in the nation. This might call for a 3.2 to 3.6 percent increase per year.

Pensions can be, and sometimes are, directly protected against inflation and the rising cost of living. The Federal employees' retirement system and the military retirement system both include an automatic cost of living or Consumer Price Index increment. Similarly, the welfare department's old age pension in Colorado contains an inflationary price adjustment to protect the retired person against changes in the Consumer Price Index.

Pensions sometimes build estates. The social security program at present is designed to provide income assurance during the life of the assured and of his dependents, and to his surviving dependents, plus a modest payment toward burial expenses. Some private and supplemental annuity insurance plans include the possibility of a payment to his estate in the event that the monthly payments to the retired person or his dependents did not exhaust the amount to his credit in the fund.

It would be possible for the Social Security Act to be amended to provide some combination of these purposes: minimum protection, plus adequacy related to prior income, plus an automatic adjustment for productivity and for the changes in the Consumer Price Index. Finally, the social security program serves the essential purposes of an estate by assuring income to surviving dependents.

These purposes are more likely to be performed equitably through OASDHI. Similarly these purposes are more likely to serve all elderly through OASDHI than through private pension plans.

C. Whose Responsibility Is Old-Age Income Assurance?

Responsibility has been shared by the State and local governments, by the Federal Government, by the unions, by the employers, by the insurors, and by the workers. The role of each of these will be considered in turn.

1. STATE AND LOCAL—OR FEDERAL GOVERNMENT?

At the outset the responsibility appeared to be heavily that of the State and local governments. In 1940, their public assistance programs paid $1.1 billion compared to only $28 million under social security benefits, for all purposes, but especially to the aged. In 1950 the public assistance programs paid $2.5 billion compared to $784 million under social security. By 1960 the public assistance programs continued to pay $4 billion, but OASDHI has risen to $17 billion and in 1966 there

was more than $20 billion paid out by OASDHI. See the attached table 1 which compares dollar expenditures for OASDHI, public assistance, and private pensions since 1940.

TABLE 1.—COMPARATIVE EXPENDITURES FOR SOCIAL WELFARE

[In billions of dollars]

Fiscal year	OASDHI insurance, Federal only	Public assistance [1]		Private employee's retirement	
		Federal funds	State-local	Benefits paid	Contributions
1939–40	0.028	0.28	0.84	0.14	0.31
1949–50	.78	1.10	1.39	.40	2.08
1959–60	11.03	2.06	1.98	1.75	5.48
1965–66	20.29	3.49	2.97	3.18	7.75

[1] Approximately half of this has been for the aged. For OASDHI, about 80 percent goes to the elderly.

Sources: Social Security Administration. R. & S. note No. 13, of Oct. 21, 1966; and note No. 7 of Mar. 8, 1967; and "Public Policy and Private Pension Programs," President's Committee on Corporate Pension Funds, January 1965.

It is evident that the 1950 amendments led to the social security insurance program taking over the major share of the burden, so that today it receives the attention which 20 years ago was largely given to the State old-age pensions. Thus the Federal Government is now paying the lion's share of the burden. However, there are still 2 million aged persons on the public assistance program of whom 1 million are wholly dependent upon it for their old-age income assurance.

Continued reliance upon State and local financing creates great inequity in the amount of protection provided among the 2 million aged as between one State and another. Four jurisdictions pay an average less than $40 a month and only four pay more than $80 a month. The Advisory Council on Public Assistance recommended a nationwide minimum plus account of significant regional variations. A mandatory national minimum may require the Federal Government paying the entire cost, at least of the minimum, with an equalization sharing of any payments in excess of that minimum.

2. THE U.S. TREASURY

In the last few years, the suggestion has increasingly occurred that the U.S. Treasury might take a larger share of income assurance through a negative income tax. One version of this plan would have the Treasury, through a negative income tax, replace the whole fabric of other income protection schemes. The more common proposal, however, looks to the negative income tax as a form of income protection primarily for the low-income employed worker, especially those with heavy family responsibilities, as a form of children's allowance system for the poor, just as the personal exemption under the income tax now serves as a children's allowance for the middle- and upper-income classes.

The U.S. tax code now loads the dice in favor of private pension plans. Thus the United States seems to be favoring plans which, as noted above, may inhibit the freedom of the worker and minimize total national productivity.

The Government loads the dice in favor of private pensions by making it possible for the corporation to pay a major share of the

whole amount of the pension contribution and treat the employer payment as a tax deductible expense item. Somewhat similar permission is extended to individuals, primarily professional persons, who may deduct up to 10 percent of their own income for payments into certain types of approved private pension plans.

The revenue loss to the Treasury from these provisions constitutes a significant subsidy to private plans. The exact amount of the loss is a matter of some dispute, depending upon assumptions used.

However, with substantially more than $8 billion currently being paid into such funds, primarily by employers as a tax deductible expense, and with income upon $135 billion in trust funds almost completely tax exempt, the revenue loss certainly exceeds the $1 billion minimum estimate reported by the President's Committee in January 1965, and probably now substantially exceeds the $3,350 million maximum estimate shown in the appendix to their report.

Had the administration and Congress been able to foresee all the consequences of these choices at the outset, it is doubtful that either would have approved the present course. It is already late to be reexamining these choices under the tax laws, but each delay makes the need for reexamination more vital.

3. THE UNIONS?

The union serves in a variety of roles to help assure that old-age income protection is available. It acts as lobbyist with respect to the Federal old-age survivor's disability and health insurance. Recently the labor movement has taken a strong stand in favor of higher benefits, a higher wage base, automatic cost-of-living adjustments, a general revenue contribution, and other improvements.

The union also acts as a bargaining agent for the workers. It has frequently been easier to win employer acceptance of supplemental pension plans than of increases in take-home pay. Among the many reasons for this preference is the desire of union officials to use this to help tie the worker to the union.

Some unions also help administer welfare and retirement pension plans. The reports of the Department of Labor would indicate that this role is only occasionally exercised by the union, and investigations suggests it is not always done well. (Discussion of corrective steps occurs later in this paper.)

4. THE EMPLOYER?

The employer accepts increasing responsibility for old-age income assurance for the longtime worker. The employer does so to hold the worker within the firm and within the industry. Where the company is a part of an industrywide retirement system, such system permits some mobility of the worker within the industry, but not beyond that point. This has proven helpful in attracting and holding persons within the industry. That it may serve to deny the worker's freedom of choice is not the immediate concern, unhappily, of either the union or the employer. Both are frequently fighting for the soul of the worker to hold his primary loyalty.

The employer's willingness thus to restrict the freedom of the worker is encouraged by favorable tax treatment, which underwrites his power to do so. If the law continues to permit the employer to return nothing to a departing employee, or only the employee's own contribution where such exists (and which for tax reasons may be only a token contribution) or to permit limited or no vesting, then the Government is indeed discouraging mobility and truly helping an effort to freeze the worker into his present job. Actually, nearly 40 percent of the workers have no vesting and 10 percent have only limited vesting, according to the President's Committee. This means the employers are helping to protect the income of only 14 of the 28 million nominally covered. Half will exercise their freedom anyway.

As a separate but related issue, in some cases the employer may welcome the opportunity to influence or control the investment of the growing retirement funds, whether or not invested in the corporation itself.

5. THE INSUROR?

The insuror—whether insurance company, a trust fund, a bank trust officer, or otherwise—simply accepts responsibility for the administration of the funds. Technically he exerts no policy influence. But he holds vast power, with limited control and almost no accountability.

Life insurance companies have included supplemental income assurance as basic to their overall sales campaigns. Maximum safety along with maximum profit will influence insurance company policy and practices.

6. THE WORKER?

He was, at one time, expected to take primary responsibility for his old-age income assurance. The great depression significantly damaged that idea. The bank failures, mortgage foreclosures, the losses in the stock market crash, the demonstration that even those who had taken all the appropriate precautions could lose their income protection, weakened the appeal of this approach among that generation. The high cost of insurance in later years makes the private insurance approach to such protection increasingly difficult to maintain. Also, the worker may feel it more important to invest in the future productivity of his children than in income assurance for himself and his dependent survivors.

The worker does, of course, protect his later years in the purchase of a home, in the purchase of insurance, the accumulation of basic consumer goods and of financial or other liquid assets. But the holdings of elderly persons, as disclosed in the sample ability of beneficiaries of old-age survivor's disability and health insurance, would indicate quite plainly that most workers do not build significant estates. Put it another way, those who need it least are most likely to have it; those who need it most are least likely to have it.

The worker has a right to view with a somewhat critical eye the manner in which the union, the employer, the trust fund or insuring agency, and the Government have discharged their individual and joint responsibilities to him and his family. For the cumulative impact of their choices has been significantly to impair his freedom if

he wishes to protect his security, or significantly to impair his security if he chooses to exercise his freedom. Both the worker and the Nation, therefore, have an interest in full, immediate, and complete vesting of both the worker's and the employer's contribution. Otherwise the worker faces an "immobility trap."

In summary, the Congress has an obligation to face plainly the consequences of its past behavior and to undertake corrective steps which will better protect the worker's security and his freedom by appropriate changes in Federal retirement programs, in the Federal income tax, and in the law concerning welfare and pension plans.

D. Are We Planning for a Healthier Future?

More people are living longer. Planning for later years must adjust to that fact. With better health and better medical care, the number of years that persons reaching 65 live will significantly lengthen. Up until now the greatest gains in longevity have been in keeping alive the children born.[1] It is also clear that some persons need to retire before age 65 for reasons of health. However, it is probable that a growing number of persons will be in good health at age 65 and more of them will be ready, willing, and able to serve in a meaningful job.

Basic questions about retirement policy

Shall law and public policy require full retirement at age 65 or some earlier date? Shall the aged spend an ever-increasing number of years in retirement, with its frequent waste of human potentials? Does not the present program seem, for those able to work and those desiring to work after age 65, a logical absurdity? Is it not a social waste when one thinks of the great persons who have made their major contributions to the human race after the age of 65? Is it not a human tragedy to put a person on the shelf by reason of a date upon the calendar rather than his own requirements and desires?

Or, to suggest an answer, might we not begin planning to encourage those who can work after age 65 who wish to do so? We could do so by providing a larger monthly benefit for each month by which they would postpone retirement after age 65. Any personal annuity program would permit this choice. Should not the social insurance program also permit such a choice? This would be a logical corollary of the present program which provides a reduced benefit for those taking their retirement before age 65. And it would meet the growing criticism of the group who continue to pay in after they have reached the age when they could draw out.

In either case, should the program not also provide the right of the partly retired worker to earn *any* amount over the allowable $1,500 minimum without loss of more than $1 for each $2 earned? This would provide an incentive to the worker to continue his employment as he saw fit so long as he felt ready, willing, and able and so long as there were employers willing to use him. And in this connection, should the Nation not also encourage work schedules and job opportunities that permit one to move from a 40-hour week down to a 30-

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[1] Medical progress in middle and later years has also been very import. E.g., estimates made in the 1930's as to the life expectancy of persons already born in the United States before 1900 were far short of the actual mark. The 1935 estimates suggested only 16 million aged for the year in which we actually reached 19 million. (Thompson and Whelpton estimates.)

hour week, or to a 20-hour week, for each and all who would find this a reasonable working time? And should we not provide, particularly for the elderly, the opportunity for prolonged vacations?

More employers are recognizing that certain employees, particularly the elderly, but also married women and students, are in serious need of work schedules other than the conventional 40-hour week for a 50-week year. Such lighter schedules could be particularly helpful for increasing the income of some of the elderly and for giving them an opportunity to participate more effectively in the society and for giving the society the benefits of their contribution to it. Several million of the elderly face this need. As time goes on, the need will be increasingly clear for a larger number of the elderly. And the need we speak of here is psychological, not just financial. Status, personal dignity, and self-realization are at stake, as well as income. The Department of Labor might will encourage more experimentation with such programs.

E. Is Aging Physiological, Psychological, or Chronological?

Present retirement policy puts the entire emphasis upon chronological retirement. However, the disability insurance does add a physiological concept to retirement. There has been little national attention to the psychological consequences of retirement. For many elderly persons this is a traumatic period, and for many it should be deferred as long as possible. However, the deferral could well take the form of part-time retirement or a reduced workload as noted above.

"Demotion from within" may be a proper supplement to "promotion from within" for the elderly. Many an elderly worker, who may no longer wish to carry the earlier full burdens of responsibility, could nonetheless make a significant contribution on a reduced workload. Many would accept a reduced base pay for a drop in rank, for a reduced basic type of job.

The Federal civil service today represents in some ways the antithesis of a desirable policy. Its present incentives for accelerating retirement are driving many of its most competent servants[2] into other lucrative employments where they can draw their retirement while being paid to serve as teachers, as salesmen, as research scientists, or whatever. But the Government is the loser. No doubt the military program has special reasons for providing such circumstances.

The Government has the responsibility to provide a wise program in its own interest as an employer. It has since 1935 accepted general old age income responsibility. It ought to perform both roles in terms which are best both for the worker and for the whole society.

It may be desirable to provide psychological and physiological tests so that those who need to retire early can do so, and to assure that those who wish to go on working after age 65, or even 70 (apart from elected officials), can do so without a special act of Congress or an Executive order.

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[2] The early retirement features were defended as making possible the retirement of the inefficient workers. But the highest incentive is to the best ones; they get the best offers from the outside, by drawing retirement pay and the new salary simultaneously.

F. The Trust Funds—Are They Responsible Capitalism?

1. THE FEDERAL TRUST FUNDS

These are no longer the occasion for battle they were in the early years. From 1935 to 1950 battles raged concerning the size and use of the U.S. Government Trust Fund; but the issue was substantially settled when it became clear that the Congress intended to use the Social Security Trust Fund primarily as a reserve to assure that benefits could always be paid. The OASDHI Trust Fund has not grown appreciably for a dozen years. The United States has moved largely to a "pay-as-you-go" system, even for its civil service retirement program. Indeed the trust fund, in terms of its ratio to annual benefits, has fallen from 1,000 to 1 in 1940, or 17 to 1 in 1950, to 1 to 1 in 1967.

The investment of the trust funds in the years before World War II was a matter of some concern. Had there been full funding, the trust fund would have exceeded the size of the prewar public debt. The profound increase in the public debt during the war years has reduced the ratio of the trust fund to a modest fraction of the total debt. OASDHI Trust Fund holdings are now but half the size of the public debt holdings of the Federal Reserve System.

Some foreign countries use a significant portion of their social security retirement funds to finance housing, to make direct loans or mortgages to certain preferred customers. In the United States, it has seemed until recently more practical to have the trust fund buy Government bonds and let the Treasury use its own funds to purchase securities of the Federal Home Loan Bank Board, the Federal National Mortgage Association, et cetera. Recently certain Government loan funds have borrowed directly from the trust accounts, removing them from the administrative budget. Of course, the trust funds can be empowered to make direct loans or make direct purchase of securities from the other lending agencies; but there seems to be more political than economic virtue in this "cosmetic approach" to budgeting bypassing the regular channels established heretofore.

2. WILL PENSION TRUST FUNDS PROVE GOOD FOR THE AMERICAN ECONOMY?

The phenomenal acceptance of pension funds has caused them to grow from $2.4 billion in 1940 to $134 billion in 1965. The rate of growth is expected to exceed 8 percent a year. This means they will double within less than 10 years. Secretary of Labor Wirtz has estimated that trust funds will exceed $200 billion by 1980. It is quite likely that this total will be exceeded well before 1980.

Searching questions have been asked about the impact of this massive power upon the American economy. Thus Father Harbrecht suggests, "The concept of ownership is meaningless since the ownership resides in a legal fiction, the financial corporation. A bare title held by a legal fiction is an inert concept. In the financial institution the concept of ownership has reached a dead end and no longer has any functional meaning, whereas the control over property which resides in the managers of these institutions is a dynamic and powerful force." [3]

[3] *Pension Funds and Economic Power*, by Father P. Harbrecht; 20th Century Fund, 1959, p. 4.

Father Harbrecht suggests that our society has passed from a property system to a power system. "The pension trusts are becoming one of the primary centers of power in the newly emerging social system. The concentration of power they represent is not the result of a drive for power itself but of the social forces that have been at work for other purposes. They are vast aggregations of wealth, neither public nor private (except in the sense that they are not owned or controlled by the state). They are 'owned' by no one in any meaningful sense of the term. Such a phenomenon in a capitalist society which has traditionally considered the distinction between public and private ownership to be adequate and complete, challenges us to find a rational framework to accommodate it. The old conceptual framework has no room for the pension trusts. The old bottles are now bursting with new wines." [4]

Writing almost 10 years ago, when pension funds were only half their present size, he said, "The power now exists in the financial trustees of pension funds to purchase enough stock to control or at least to influence our corporations." [5] Or, "Certain large New York banks will soon approach a point where their combined holdings of stocks for pension funds could give their opinions considerable weight in the councils of the larger corporations." [6] "What we are witnessing is a genuine evolutionary development rather than a temporary consolidation of power resulting from personal acquisitiveness." [7] He suggests that the time has come to declare that the "assets of the pension funds rightfully belong to the employees." [8] For, he finds, "They cannot be said in any proper sense to be 'owned' by either the employer or the employee. In fact no one actually 'owns' them, although at the present time many of the prerogatives of ownership are being exercised by pension fund managers and financial institutions." [9]

He comments, "Control by the employees for whom these funds were created is nonexistent. The employee does not become independent by reason of a body of capital wealth gathered for his benefit, but through his dependence on this wealth he has become subject to the decisions which are made by others concerning his welfare. Capital reserves dedicated to an employee's future may work to free him from want but they do not make him more independent. The employee gains economic security without corresponding economic power * * *. While there is no gain in economic power for the employee there is a considerable increase of power in the corporate employers, in the labor unions, and in the financial trustees on the economic side, and in government on the political side. Power follows property and it does so inevitably. Thus power has come to those who control the concentrations of property that have been created to serve our workers * * *. The growth of these new powers along with the powers already in the hands of the corporations is producing a society whose economic life is based on a structure of the power that results from the control of property. It is not a society organized by individual property ownership and diffused power. Property ownership is not the organizing prin-

[4] Ibid., p. 11.
[5] Ibid., p. 249.
[6] Ibid., p. 248.
[7] Ibid., p. 250.
[8] Ibid., p. 268.
[9] Ibid., p. 271.

ciple; power is. Thus the direction of the transition," says Father Harbrecht, "to the paraproprietal society." [10]

"Institutions that determine a man's relationship to productive property and to other men are the structuring elements of today's society insofar as it is given form by economic relationships. Thus we conclude that a man's relationship to things—material wealth—no longer determines his place in society (as it did in a strong proprietary system) but his place in society now determines his relationship to things. This is the consequence of the separation of control over property from individual ownership. The name given to this new type of society, paraproprietal, is an attempt to express in a word the nature of its structure. Our society is called paraproprietal, or beyond property, because in it the connection between man and things, which is another way of saying property, is so attenuated that the fundamental function of property is not dominant though it still serves a purpose." [11]

He concludes his book by calling for us to continue "to press for a system in which corporate management and the private individual will behave responsibly with regard to the common good * * *. Care and concern over material wealth will always be the task of every man to a greater or lesser degree and we cannot be indifferent to the alinement of powers over property." [12]

Some of the same concerns have been expressed more recently by the staff of the Federal Reserve Bank of Chicago. In an article in their publication "Business Conditions" for September 1966, the staff found 1965 net receipts of private and State and local pension funds to be $12 billion. They found these funds heavily invested in corporate stocks and bonds. They found the market value of these funds to exceed the total assets of savings and loan associations or of life insurance companies exclusive of reserves of the insured pension plans. Stocks now represent the major portion of the new investments, with corporate bonds drawing another one-fourth.

"The total market value of all stock of the United States corporations was estimated at almost $780 billions at the end of 1965. Individuals—including personal trust funds—owned the great bulk (86 percent) of this total. Next to individuals, the largest group of stockholders were the pension funds with almost $40 billion or 5 percent of the total. Open end investment companies (mutual funds) held $31 billion in stock, 4 percent of the total. Stockholdings of pension funds first exceeded those of open end investment companies in 1959. The gap has widened each subsequent year.

"Pension fund purchases of stock are much more important than indicated by the proportion of total stock they own. For one thing, the funds confine their purchases almost entirely to blue chip stocks of large, well-managed firms typically listed on the New York Stock Exchange. These funds owned about 7 percent of all the stock on the big board and much larger proportions of particular issues.

"Several of the firms have assets of $1 billion or more. Placing even a tiny proportion of their assets in the stock of a moderate sized firm could influence the price of these shares substantially. Moreover, siz-

[10] Ibid., p. 285.
[11] Ibid., p. 287.
[12] Ibid., p. 289.

able holdings of stock of smaller firms could result in the pension fund gaining working control, a development frowned upon by Government and most fund managers alike."

Sales of stock on the New York Stock Exchange involved 14 percent of the market value during the year 1965. Pension funds accounted for 10 percent of the total volume either as buyers or as sellers. Pension fund purchases of stock exceeded sales by $3 billion. With new stock issues averaging less than $1.1 billion a year for the past 6 years, pension funds obviously are buying up existing shares of stock. What would have happened to stock prices if pension funds had not been buying so heavily, asks the Federal Reserve bank staff. While State and local pension funds have increased their corporate stockholdings from only 2 percent up to 5 percent of their assets during the last 5 years, they have greatly increased their holdings of corporate bonds, moving from $6 up to $15 billion, or from 33 percent to 47 percent of their assets in 5 years. State and local plans are more like private plans than like the Federal plan.

During the period 1960–65, State and local pension funds and private pension funds acquired $22 billion in corporate bonds. "Together these institutions accounted for over 54 percent of the increase in outstanding bonds during this period." [13]

The article concludes "a number of questions arise concerning the growing common stock investments of private pension funds and State and local plans * * *. First is the question of control or lack of control over management of firms in which stock is purchased. There is little evidence that pension fund managers have attempted to use their voting powers to control operating management. In fact, many trustees specifically avoid any participation in annual meetings or proxy fights. But here is a dilemma. These trustees are among the most knowledgeable stockholders and presumably have a duty as well as a right to scrutinize and criticize the activities of firms in which they hold shares.

"A broader question arises about the economic effects of pension fund stock purchases. Newly issued bonds or mortgages provide the funds for new investment, but common stock is purchased almost invariably in a 'secondhand' market. Money is transferred from the funds to existing holders of stock certificates. No data is available on the use of funds by individuals who liquidate stocks."

And finally, "Experience of pension funds with stock investments has been 'favorable' in that capital gains have been achieved . . . The apparent success of the decision to invest in stocks has been validated, in large degree, by the purchases of those making the decision. Pension fund managers buy stocks expecting prices to rise, and it may be that prices have risen in large degree because pension funds have directed such a large portion of their net inflow to stock purchases." [14]

Four basic questions are presented by this discussion involving the very nature of the American economy:

(a) *What is the fund impact upon the size of the economy?*

There is little indication that pension funds cause covered workers to reduce their savings. Indeed, workers with pension rights tend to

[13] "Business Conditions," Federal Reserve Bank of Chicago; September 1966—p. 18.
[14] Ibid., pp. 19–20.

save *more* in other ways than those who do not have coverage. Pension reserves represent net additions to personal savings. Moreover, they represent a contract type of savings not likely to be appreciably reduced as the years go on. As plans mature, a somewhat larger outflow of funds can be expected, however. If the funds are used to buy up existing stocks rather than be invested in new activity to expand the economy, the question may well rise as to whether the funds are fully encouraging growth or merely changing the ownership of assets, (no data is available on the use of funds by individuals who liquidate stocks) and possibly restraining economic growth.

(b) *What is the impact upon the direction of the economy?*

When a small number of trustees responsible for the investment of billions of dollars each year can negotiate directly with those who would borrow money, whether through corporate bonds or through a mortgage bond, these trustees enjoy very great power over the direction in which the American economy will be moving. Is there any evidence that this power is used wisely and for socially beneficial purposes? Is the housing that is financed serving the needs of the lower- and middle-income persons for whom these funds are being accumulated? Or are these for high-rise luxury apartments? Are the funds building new productive equipment? Are they financing new shopping centers which serve to make more rapidly obsolete already existing shopping centers? Are they encouraging new dynamic developments to increase the welfare of the American consumer? Are trust officers of banks or insurance company executives the best persons to make such investment decisions? Is there any way by which the utilization of trust funds can be encouraged to serve more fully the needs of all Americans? Is the investment of vast sums which ultimately belong to the workers (whether or not this be legally established) being conducted so as to serve their interest by the best use of the capital acquired, or only by use of funds derived as income from the capital investments? The trustee relationship here is of great consequence and growing greater with each passing year. Undoubtedly the sense of trusteeship would be improved by accepting Father Harbrecht's suggestion that ownership be viewed as vesting in the workers.

(c) *What is the impact on the performance of the economy from year to year?*

The Federal Reserve Bank of Chicago notes, "In the late 1950's and early 1960's, it is generally agreed that the U.S. economy was operating below its potential. The sector lagging most noticeably was business investment. Nevertheless, additional spending by consumers based on high current cash income or reduced saving might have stimulated additional expenditures for new plants and equipment." [15]

While managements seek to fund their plans fully and as soon as possible, they do tend to vary annual contributions in response to variations in before-tax profits. The Federal Reserve study notes that employer contributions declined in 1954 and in 1958 and increased only slightly in 1961.

[15] Ibid., p. 19.

Pension programs tend to become virtually a contract form of savings which are relatively inflexible and not significantly reduced during economic down-turns. Nor do they rise rapidly during a period of rapid increase. Trust funds, therefore, may well be said to be a built-in destabilizer rather than a built-in stabilizer. As the size of funds increases and the annual outlays for such programs increase, it may become more and more important to examine the impact of the flow of these funds on the economy. It may become necessary to invent tax incentives or policy guidelines which will help assure that the flow of pension funds will, in fact, prove to favor the orderly growth of real investment in the economy.

This brings up an even larger question about tax policy, investment, and corporate structures: Against the market value of common stock last year, roughly $3 was paid out on each $100 of value and $4 was retained as earnings. Present tax concessions to capital gains continue to encourage this process and have operated to discourage the use of new issues of common stocks to raise funds for the corporate enterprise. The effect of this has, of course, helped to encourage the purchase of common stocks for the chance of capital gains by pension funds which have no special tax incentives to seek capital gain in place of cash income. But the effect nationwide has been to have $47 billion in retained earnings currently available for reinvestment by the managers of the corporations in which the funds arose, in addition to the depreciation allowances now exceeding $60 billion. The stockholder does not have a choice as to where he would prefer to invest the earnings that flow from his investment. It would be more equitable to distribute corporate earnings to the stockholders. Those whose tax rates were low, would rather receive cash dividends than capital gains. Those whose tax rates were high have no special reason in equity or in economic policy to be favored with a tax concession. The committee might wish to reexamine the tax treatment of capital gains and of cash dividends made upon stock. Corporations could be encouraged to distribute most of their profits by permitting cash dividends to be deducted along with other allowable corporate expenses in computing the tax base for corporate income taxes. Along with this should be a treatment as fully taxable income of all capital gains from the sale of financial instruments, regardless of how long held. (Whether or not to continue a tax favor for capital gains from the sale of houses or other real property is a separate but certainly related issue.)

Such a proposal assumes not only the closing of a major tax loophole and greater equity as between wealthy and low income stockholders, but also it assumes that management would then undertake to issue new common stock to provide additional investment capital for its expansion. This would mean that investors including pension funds could buy new shares, rather than simply bid up existing stocks. It would provide an orderly use for the funds coming into the hands of stockholders, and of trustees of pensions funds and other mutual investment funds. It would increase the true earnings of such funds. Most of all, it would restore a real role for the investor in a capitalistic society by permitting him to choose where to reinvest his earnings. It would help restore substance to the capitalist society and not merely observe its form. It would make stock ownership among lower income

families much more attractive by assuring them that cash dividends would flow from their equity share of the corporate enterprise.

It would throw into sharp focus the question of the reasonableness of investment in new as against old stock by pension and other trust funds. Such a tax change would greatly reduce the corporate income tax revenue, but would increase personal income tax revenue much more equitably. It would put an end to the present tax discrimination in favor of debt over equity instruments in corporate financing. It would restore to a place of importance the sale of new corporate securities. But the role of trust funds as major investors would still call for some greater measures of accountability by fund managers.

(d) A fourth question: *Can management responsibility be assured through greater accountability?*

With ever larger sums available to them, trust funds are becoming a popular source of mortgage market funds for large commercial and industrial mortgage placement. It is very difficult for an insured worker (and even some fund trustees) to evaluate meaningfully the bona fides of proposed transactions. The opportunities for hanky-panky are thus greatly increasing. The proposed 1967 amendments to the Welfare and Pension Plans Disclosure Act to make it a *protection* act provide a hopeful corrective. The Yarborough, McClellan, and Javits bills would define the trustee's responsibilities, impose liabilities for breach of duty, and provide remedies.[16] If such legislation were applied to all trust funds and enforced, it would certainly prove helpful.

Some fund executives and trustees have abused their responsibilities through manipulation of trust funds, without necessarily violating any existing law. Self-dealing or dummy corporations have been used for excessive management fees, for mortgage amounts that are excessive (sometimes above the true purchase price of the property), for dealing in stocks to their own advantage, et cetera. Moreover some trustees have collected a placement fee from the trust fund for loans made through a dummy corporation that they owned! No doubt chronic inflation will often make even a bad deal ultimately look good. But too often the beneficiaries suffer while the trustees gain, and continue free to make other deals. The present disclosure law is not enough. All pension and welfare funds should come under the protection of law, defining fiduciary duties, requiring annual audits, much greater accountability, and prohibiting self-dealing and excessive fees.

In summary—A free competitive enterprise capitalistic economy presumes that along with power there goes not only responsibility but also accountability. The power piling up in trust funds is virtually without accountability, for the covered employee is not by himself a competent analyst. He cannot know from looking at a portfolio or an annual report whether the funds have been competently, properly, or wisely invested and he does not know, nor perhaps care, whether the vast power over the lives of individual corporations piling up in the trustee's hands is being used in his best interests or in the best

[16] For a complete discussion, see "The Law, the Pension Fund, and the Trustee," a paper presented to the 20th Annual Conference on Labor at New York University, Apr. 19, 1967, by Frank M. Kleiler, Office of Labor Management and Welfare Pension Reports, U.S. Department of Labor.

interest of the corporate enterprise over which they are gaining increasing control. The legislation must increase his protection and remedies beyond those now available.[17]

Is it really the intent of Congress that the American economy should see an increasing separation between ownership and control? The failure of individual stockholders to interest themselves in the operation of the modern corporation already reflects some such separation. James D. Burnham discussed "The Managerial Revolution" nearly a quarter century ago. But the trust funds are more important because they provide an institutional basis for completing the separation between ownership and control, for completing the separation between responsibility and accountability.

The Congress, and economists as well as business executives, ought to face up to the question of "whither are we tending?" Are the managers of mutual funds and trust funds to be the potential oligopolists of tomorrow? Are these to be the managers of a new private collectivism? If so, may these not prove to be a possible prelude to a later demand for public ownership? Might not such power without accountability become a stepping stone to socialization? Certainly they provide an easy route toward nationalization of enterprises. So long as such great power is being exercised with little accountability and less control, these funds can be characterized as mindless giants turned loose in the American economy. Must catastrophe occur before adequate precautions are taken?

3. DO PENSION FUNDS ASSURE EQUITY?

There is a growing chorus of concern with respect to pension plans as to their protection of all workers, as to their financial protection, legal protection, their protection of living standards. Some of these questions were asked in Father Harbrecht's book, and more recently, by Merton Bernstein, in "*The Future of Private Pensions*." [18] Out of an unusually rich background of experience, Bernstein has been able to identify and establish in substantial detail many of the major questions. He has proposed an answer which differs somewhat from the one which appears below, but it looks in the same broad direction.

(a) *Is employee freedom, mobility, and turnover restricted by tenure and vesting?*

Ours is a highly mobile population. Among the young workers, changes in employment are quite frequent. Among women the retirement from the labor force during the years when their children are young is common. Only among older males, say those over 40 years of age, is there likely to be substantial continuity of employment. Even such workers frequently find reasons of family, of career, of climate or health, which justify a change of employment in later years.

Retirement systems have built-in inhibitions against exercise of that freedom. Of the 28 million presumably covered by existing plans,

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[17] Profit-sharing plans raise special problems not dealt with here. These might not be considered as pension plans. They deserve new scrutiny, and probably new safeguards for the worker and the public.

[18] Published by the Free Press of Glencoe, 1964.

given present plan characteristics, fully one-half, or 14 million, are not likely to remain under such a plan until they are eligible for the benefits.[19] There is every reason to believe that our society requires increasing rather than less mobility. It requires this because of the rapid rate of change in technology. It requires this because of the necessity for workers to adapt to rapidly changing circumstances in their own separate field or employment as well as in the companies and industries with which they work. Yet pension plans do not fully protect the old-age income assurance of the half who, for reasons of personal income advantage during their working career, for reasons of family life, and for reasons of contribution to the national economy, must change jobs.

Increasingly liberal vesting arrangements will help some, but short of total vesting of the employer's as well as the employee's contributions from the first day of employment, there is no complete protection for the persons seemingly covered by private pension plans. Only by accepting Father Harbrecht's position that the contributions belong to the employee from the outset, is there any protection for those who must be mobile, who must show up in the turnover statistics.

Because complete and immediate vesting is contrary to one of the purposes of the pension plans; namely to hold workers on the job, it is most unlikely to occur unless Congress were to require it as a consideration for tax exemption of the contributions.

Practically all plans in which there is an employee contribution give the employee back his portion in the event he withdraws. But since his portion is, overall, roughly one-seventh of the total contribution, this is the appearance of equity without the reality of equity.

Because the pension plans are mostly in their early years, they have not yet been a major handicap to mobility. But as workers become conscious of their growing apparent equity in such plans, the inhibitions on freedom and mobility can be expected to grow, and criticism to mount. Constructive action to improve the worker's equity becomes increasingly important to him, and to the rate of growth of the national economy, which requires mobility.[20]

(b) *How adequate is the financial protection the funds provide?*

The adequacy of the amounts in funds may be examined from two points of view. Given present plan provisions and the likelihood that half the persons nominally covered will not be around to draw benefits, there is no doubt that the contributions tend to be overstated. The most prudent actuaries tend to use a low turnover rate and to use low interest or earning rates, and such biases will yield higher cost estimates than are justified by existing experience with turnover and earnings. Other actuaries are under some sales pressure to understate the costs. Depending on the pressures, and the assumptions used as a result, funding may be more or less than adequate.

However, from the standpoint of ultimate costs for adequate pensions that fully protect all workers, the presently stated costs are undoubtedly fairly low and the funds will prove inadequate. By way

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[19] See chapter VI, *"Prospect of Benefits,"* in "Labor Mobility and Private Pension Plans," BLS Bulletin No. 1407, June 1964. U.S. Department of Labor. For example: "45 percent of the workers if hired at age 25 would not qualify for any benefit by age 50 under the plans." P. 51.

[20] Ibid., p. 49.

of comparison, the Federal Reserve Board's own retirement plan, which is approximately equivalent to the U.S. civil service plan, now takes 22 percent of wages, of which the employee pays less than one-third. The costs approximate 6 percent for the employee and 16 percent for the Federal Reserve Board. While the civil service plan has an equal cost, it is not fully funded, and therefore the Government's ultimate contribution has been substantially deferred. The time will come when payouts will require very significant increases in the Federal contribution, parallel to the Federal Reserve plan, which tries to be fully funded on an accrual basis.

The adequacy of funding is not a major question for a corporation which has reasonable security with respect to its longevity. Obviously, deficiencies in prior funding can be made up out of increased contributions paid out of future earnings—if there *are* future earnings. We will examine below the protection afforded during shutdowns or mergers or bankruptcies.

Clearly, existing funds are growing rapidly. Payments are being made to those eligible in the amounts intended. For most workers who are now achieving eligibility, there is no reason to be concerned. Clearly also, however, if plans become increasingly liberal so that they afford in fact the protection to all workers they appear to afford in theory, then they are inadequately funded. But it will take years for this to become evident because by their nature retirement plans mature very slowly.

The more immediate tragedy is that the financial protection the worker thought he was acquiring may disappear like dew in the morning sun when automation hits the industry, or when a personal tragedy, changing family circumstances, or other causes require him to be separated from the firm before he has achieved the protection the funds were set aside to provide. Unless there is vesting and he has attained the age and years of service it requires, there is *no* protection.

(c) *Do pension funds protect when the jobs leave?*

"The great strength and vitality of our economy may give the impression that most companies, especially the large ones, are stable, solid, unchanging, and permanent. In fact, the forces of change constantly challenge the powers of permanence. Perhaps it is unthinkable that any of the great manufacturing or commercial corporations is mortal. However, that formerly great railroads have vanished as separate entities should serve as a warning. The short and unhappy life of the Ford Edsel Division demonstrates that even the most solidly planned and financed enterprises perish." [21]

Pension plans disappear. Some 3,357 plans were terminated between 1956 and 1962. About one-half of these were profit sharing; the other half were pension or annuity plans. Mergers, corporation dissolution, financial difficulties and sales of companies lead the list of causes. The average plan terminated in New York covered 350 employees. Data on mergers and their effect on plans is woefully inadequate.

There is serious need for the Congress to order a regular gathering of data with respect to the impact on pension plans of terminations, mergers, sales, shutdowns. Bernstein summarizes many specific situations and discusses some of the case law. He concludes, "constant

[21] Bernstein, op. cit., p. 85.

changes in employer location, organization, and ownership, which are so characteristic of our economy, constitute an indeterminate but substantial threat to continuity of employment and therefore to pension expectations which are based primarily upon single employer plans. Contractual and judicially fashioned job transfer rights for employees would mitigate their impact to a limited extent. However, more basic changes in pension arrangements probably are required if they are to be able to overcome the limitations of single employer plans when subjected to the strains of such exigencies." [22]

In a review of some illustrative cases, Bernstein, notes in chapter 5 in some cases large groups of employees lost substantial pension credits because the courts refused to vary the terms of the plans to accord rights not affirmatively conferred by the plan itself. "At least in some instances, the employees' losses resulted in monetary returns to the employer which were so large that they exceed what could have been expected from normal turnover." [23]

A review of the cases would indicate that case-by-case solutions are not likely to be very satisfactory. Pending the adoption of some more sweeping reform, the best answer is Father Harbrecht's suggestion that the law vest full equity rights in the workers. Inasmuch as the funds are treated as compensation in the bargaining arrangement and by the Treasury, there is good reason to suggest that the compensation rights vest in those who are expected to receive them. Then, assuming no more sweeping reform, the courts might well provide arbitrators to administer pension rights in the event of plan terminations for whatever reason. Certainly it cannot have been the intent of the Congress to provide what Bernstein properly characterizes unjust enrichment of employers as a consequence of plan termination. Bernstein concludes, "It would be difficult to conclude that the present pattern of single employer pension plans will afford adequate security to the tens of thousands of employees who could be affected. And it is difficult to conclude that the courts presently are sufficiently solicitous for the interests of employees when their pension expectations are put in jeopardy by plant and unit shutdowns." [24]

(d) *Should private pension plans provide adequate protection of retirement income?*

Clearly, it will require the virtually universal coverage of the social security program to assure a minimum standard of decency to every worker and his dependents as retirement is reached. There has been increasing acceptance of the proposition that social security should provide benefits based on a larger fraction of the first dollars of preretirement income than of the later dollars in the average monthly wage. There is also acceptance of increasing the minimum benefit to any qualified beneficiary. And there appears to be growing acceptance of the concept of increasing the wage base so that social security benefits continue to discriminate between those with minimum income and those in the middle and upper middle income brackets. Were this not to be done, social security would ultimately, by the change in wage levels, become a flat benefit in which the maximum would become the minimum as a flat benefit.

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[22] Ibid., p. 113.
[23] Ibid., p. 118.
[24] Ibid., p. 138.

In light of this changing pattern for old-age survivor's disability and health insurance, the role of private pension plans, except for those few public employees who are not covered by social security, is to supplement whatever benefits social security provides. This more nearly accords with the purposes of the employer and the unions in negotiating such plans. The formulas used in such plans tend to give heavy weight to the number of years of service so that the supplement will be a function not only of the wage level for retirement but of the length of service with the corporation or the insurance plan.

In other words, *the existence of private supplemental retirement plans is no substitute for having an adequate social security program.*

What about *inflation?*

Many private plans provide that the benefit shall be based upon the earnings during the last few years before retirement.[25] This protects the worker both with respect to his highest income and to the price levels at the time of retirement. However, plans do not usually adjust benefits to rising living costs *after* retirement. Some beneficiaries will live as long as 30 years after retirement. For them, the benefits in later years will be scandalously low. Neither the employer nor the union feel a strong obligation to the person already retired. Hence his bargaining position is very poor. A few plans do have a cost of living adjustment. And those plans which are based upon profit sharing may provide a better hedge against inflation. College faculties have been provided with a combination program: the TIAA annuity portion is invested in debt issues and gives a fixed income payment; the CREF (college retirement equities fund) portion is a variable annuity, based on the value of the shares, and recomputed each year.

However, as noted heretofore, the increase in stock prices may very well be a result of the increasing use of variable annuity plans. The program will prove self-defeating unless some device for encouraging increased equity shares is made available.

Effectively, only the Congress can assure aged persons that their monthly benefit amounts will be adjusted periodically to take account of changes in the cost of living. Inasmuch as inflation is a result of governmental policy, both monetary and fiscal, it seems appropriate to suggest that the Government protect the adequacy of pension plans by an orderly cost of living adjustment from time to time for all retirees and their dependents.

What about *productivity gains?*

Shall the income of an aged person be frozen at his retirement level except for cost of living adjustments? Or shall those on retirement benefits share in the annual increase in productivity of the national economy?

Profit sharing plans solve this question, not in terms of the productivity of the national economy, but in terms of the profitability of the firm providing the supplemental pension. This may provide a somewhat more variable payment than would flow from a productivity adjustment, whether 3.2 percent, 3.6 percent, or some other number per year. The variable annuity formulas depend entirely too much upon the capital gains features and the value of their assets. Only

[25] About 55 percent use earnings and service formulas; of these half are based on career earnings, but there is a growing use of terminal earnings.

the Government can provide an orderly annual adjustment for productivity changes. It should do so regularly through the social security program.

(e) *Who will protect the worker's equity in pension plans?*

If the worker is not protected through vesting in the event of turnover, if he is not protected in the event of shutdown or merger, if his benefits are not protected against inflation, if the retired worker is not protected against falling behind as the retirement years wear on, how shall he be protected? Will he be protected:

1. By better information? The Government ought to require regular reporting to all persons covered by such plans as to the nature of their coverage along with their rights and privileges, as well as the limitations thereon. It ought also to require disclosure of the uses of the funds and of the current income and expenses as well as the assets and liabilities. It ought also to require and prescribe proper practices for those responsible for the handling of such funds. State banking and insurance laws are inadequate and State bank and insurance departments are inadequate to this task. Only the Federal Government can undertake it.

2. By the unions? Inasmuch as most of the contributions are made by employers rather than by employees, the unions have somewhat less bargaining power than if they were discussing the contributions made by employees. The absence of an employee contribution has proved to be a weakness in unemployment compensation, and it is proving to be a weakness in pension plans.

The unions, like the pension plans, have a built-in bias in favor of oldtimers against the newcomers, in favor of the regular workers against the irregular workers, in favor of the employed workers against retired workers. These are all part of the built-in resistance to early and full vesting. These are a partial resistance to bargaining for inflation and productivity increments in existing pensions. These are a part of the resistance to hiring older workers. Retirement systems sometimes serve to put a ceiling on the age of entry into the program and thus into employment. Thus freedom to transfer jobs may be effectively restricted to those under 40 or even under 35 in order to avoid the increasing cost of pensions for persons hired in later years.

3. By the employers? The employers do not fully share the union bias. Many patterns are visible. Some may share opposition to late entry and to hiring older workers. Some appear to encourage personnel turnover to avoid pension costs. Some even find some cause for dismissal short of the initial vesting period. Some show a bias in favor of front office and executive personnel. Employers could conceivably agree to transfer retirement credits from one retirement system to another so that a worker's payments and benefit rights would be cumulative in more than one employment. However, neither the employers nor the unions have much interest in those who leave an employment. It will take an act of Congress to assure meaningful supplemental protection to those who, for whatever reason, move from one employment to another, from one retirement system to another.

4. By the courts? Until plans are drawn with greater concern for the rights which may be endangered, whether by worker mobility, by

change in corporate ownership, or by dissolution; and until the Congress provides, or the Treasury regulations require, recognition of the equity of the workers in the funds, it is unlikely that the courts will protect workers beyond the letter of the plan. Because the worker does not discover his loss of protection or the inadequacy of his protection until he has left employment or has been retired or been discharged, his standing in court is limited and evidently insufficient to protect him.

5. Or by the Congress? It will take an act of Congress to provide greater assurance of the workers' legal rights. *Assigning the equity in the funds to the covered workers would be a major step forward.* Short of such a step, Congress will continue to receive from time to time, the anguished letters of outrage from workers who discover too late that the plan did not provide in fact the protection they had believed it to provide in principle.

In summary—One cannot anticipate that the systems will be modified without further congressional inquiry and direction. The basic question is: Are the present consequences the ones that the Congress seeks? If these are not, should not this inquiry lead to a fundamental redefinition of public purpose and public policy? This total inquiry is an ideal opportunity for such a reexamination. It ought not to be neglected.

G. Suggestions for Reconciling Security, Freedom, and Equity by Increasing Each

1. *Increasing wage base and benefit amounts.*

Private pension plans were, in part, a response to congressional timidity during the 1940's as to increasing the wage base and the benefit amounts under the Federal old-age benefit program. The original $3,000 limit on the wage base included all the earnings of virtually 95 percent of covered workers. The failure over the years to permit the same extent of coverage to be reflected in a growing wage base is one of the prime reasons for the widespread adoption of supplemental programs. It is unlikely that supplemental retirement programs will ever be abandoned by reason of a more adequate old-age survivor's disability and health insurance. Yet it is certainly essential that the benefit levels be significantly improved by increasing the wage base, by making coverage truly universal, by increasing the maximum benefit amount (with benefits proportionate to covered wages), and by providing a more reasonable minimum benefit to all who qualify. Yet even after these steps have been taken, there will be need for some form of supplemental pension to accommodate both employers and employees who wish to assure higher retirement benefits.

2. *Cost of living and productivity benefit increments.*

No doubt, if the Congress were to include both a cost-of-living adjustment and a productivity increment into the basic retirement system, the pressure for supplemental benefits would be reduced. But clearly the Congress ought to assure, on a continuing basis, the proposition that every man ought to have his necessities of life provided, especially during his retirement years. The Congress ought to accept the proposition that this is done not only out of love of fellow man but out of a

desire that the entire society be strong. And for the whole to be strong, each part of it must be strong.

3. *Voluntary supplemental group annuities—the next step.*

The voluntary supplemental annuity was discussed in the 1935 report of the Committee on Economic Security. Attention in those days focused on voluntary individual annuities. These almost always encourage adverse selection of risk. That is to say, workers whose parents and grandparents died while in their 90's are more likely to choose supplemental retirement annuities than workers whose parents and grandparents died in their 50's. This problem can be avoided by providing voluntary supplemental *group* annuities. Such a program was part of my testimony before the Senate Finance Committee in the hearing on the 1950 amendments,[26] elaborated in subsequent letters to members of the committee.

I renew the suggestion that the Congress actively study the possibility of providing a Federal program of voluntary supplemental group annuities. This would be administered for groups working under one or a group of employers and covering all employees in such a group. The contributions, whether from employees or employers or any combination thereof, should be fully and immediately vested and be completely cumulative for the worker whether he be covered by one employer or by 10 such covered employers in the course of a working lifetime. The benefits under such a program could be paid out, based upon total contributions plus accumulated earnings, on a straight actuarial basis to the worker, with the usual standard options. If the Congress saw fit to do so, it could subsequently add a productivity and a cost-of-living adjustment to these annuities. It is highly unlikely that the private pension plans would ever be able to offer such adjustments. Such an adjustment would more than compensate for the lower earnings rate on Government trust funds.

There were three basic arguments I offered in support of this plan. "First, it would assure the worker that the exercise of his freedom would not jeopardize his security. He could move from one covered employment to another and accumulate his benefits in his supplemental pension annuity. Secondly, if Federal programs were to absorb and thus replace some or all of the existing plans, it would cut the cost of administering such plans and improve the total funds available for payment to the annuitants. And thirdly, only the Government can take the risk of annuities. With the science of geriatrics constantly prolonging life, this is a bad business for private concerns. But the Government can and should take the risk." These were my words of 1950. I repeat them now. The essence of the argument is that only the Congress can provide additional security without some loss of freedom.

In testimony before this committee in 1955, I suggested that the Government begin the process by transforming its own civil service and military service pension programs into a voluntary supplemental group annuity, and integrate fully the regular retirement program with OASDHI.[27] I suggested as a second step that a similar package then

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[26] See hearings, Committee on Finance, U.S. Senate, January 28, 1950.
[27] Subcommittee on Low Income Families, Joint Committee on the Economic Report, Hearings, Nov. 18, 1955; Washington, D.C.

be offered to the public school employees, to the police and firemen, and to the other State and local employees; adding, "When this had been successfully consummated, it would be time enough to offer such supplemental annuities on a group basis to private employers. Many millions of workers are in for disillusionment in the years ahead as they find that their rights in their company and union plans are not vested at all; and many others will have their rights vested only after periods of service." Nothing that has happened in the past 12 years has weakened the argument I made then. However, some progress has been made toward increased vesting.

4. *Other alternatives*—

Merton Bernstein became interested in this topic and began his inquiry in late 1959. His book, published in 1964, comes to a conclusion similar to that I had stated above. He observes, "No proposal for vesting in the United States has included any device or institutional arrangement whereby vested rights follow the employee, rather than, as at present, having the employee and his credit go separate ways until retirement.

"The possibility of small, perhaps miniscule benefits, the incompatibility of benefit provision, disproportionately high administrative costs, attrition of fixed benefits by inflation, withdrawal of contributions, their lack of utility for the disabled, and the nonparticipation of vested deferred benefits in plan improvements, all argue for the desirability of collecting the bits and pieces of employees' vested pension credits into one more adequate benefit, a benefit based upon contributions which have earnings and growth up to the date of retirement. * * * such piecing is not presently possible; no device exists in this country for transferring and cumulating credits. In my discussions starting in 1959 with officials of insurance companies, banks, pension consulting firms, unions, management, government, and academics I found interest in some device to coordinate plans or benefits." [28]

Bernstein reviews a variety of possible devices for what he calls a "pension credit clearinghouse." These range from a simple record-keeping and reporting system, to a clearinghouse transfer system, to a voluntary supplemental annuity plan such as I have suggested heretofore. He also examines the possibility of doing this as a private plan, as a mixed plan, and as a public plan.

While Bernstein does not make a firm choice among the alternatives, he does say this, "The future of private pensions will be whatever we make it. * * * Presently, private plans are designed to supplement OASDI benefits for a minority of those who work. How large or small that minority will be cannot be ascertained with any accuracy. About one-third to one-half of the civilians who work in nonagricultural, nongovernmental jobs, are under private pension plans. Perhaps half of them will achieve benefits under their present plan; very likely less will. Some of those who fail to achieve benefits under their present plans, will do so under plans they enter at a later period in their working life, hence their benefits will be below the optimum. How many fall into this category, no one can say—indeed, no one has guessed.

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[28] Op. cit., Bernstein, p. 264.

"So the present system, left unchanged, may provide benefits to about one-sixth to one-quarter or even less of the civilian population privately employed in nonagricultural work. Most of those who do achieve benefits will have them based upon only a portion of their working life, the later years." [29]

"A clearinghouse arrangement, including a central group plan for employees without planned coverage, has all the flexibility of private plans * * * plus the universality which is the great strength of the OASDI system. Those who desire and can afford such a supplement, can achieve it under the transfer value-clearinghouse method, if, as seems likely, it facilitates the spread of plans and vesting. Such a system will require more funds, because benefits must be paid for. But by virtue of longer periods of earnings for contributions made on behalf of each employee, less of the benefit would derive from contributions and more from earnings * * *

"If the proponents of a strong system of private plans wish that this system prevail, they must act in the near future to make it a mass program with ample supplements to OASDI. Otherwise they run the great risk that private plans will be discredited for providing too small benefits to too few people, or ample benefits to even fewer. In short, the private pension system runs the risk of condemnation as a class program when the level of OASDI benefits requires a mass program of supplementation." [30]

"Vesting as currently practiced seems of quite limited value to the great majority of those under plans—and perhaps even more limited for those to whom the plans may be extended." [31]

He concludes his volume with this statement: "The decisions to be made are myriad. Most—at least in the short run—are to be made by private groups, principally employers and secondarily unions. But Government has duties which are not being fully discharged. There is not a great deal of time before the fruits of pension plans will be in demand. Indeed, for millions, harvest time is close at hand. We cannot afford to fling the seed broadcast letting it fall where it may to yield with uncertain quantities as now we do. We must plan, select, and suit what we plant to what we need and can afford. Our soil is rich, our seed is sound, our experience rich in example. There is no reason for a short or bitter harvest." [32]

Another alternative becomes possible through the use of a new series of U.S. Government bonds—U.S. retirement plan bonds under the Self-Employed Individuals Tax Retirement Act of 1962; these bonds are not restricted to self-employed individuals or plans established by them. Any pension plan which meets the qualification requirements of section 401(a) of the Internal Revenue Code may invest in this new series of bonds.[33]

The bonds may be purchased at any Federal Reserve Bank or branch, or direct from the Office of the Treasurer of the United States.[34] Banks and other financial institutions take applications for issue and redemption of these bonds for transmittal to the issuing agents.

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[29] Bernstein, op. cit., p. 299–300.
[30] Ibid., p. 301.
[31] Ibid., p. 301.
[32] Ibid., p. 302.
[33] Internal Revenue Regulations, sec. 1.405—1(a).
[34] Code of Federal Regulations, pt. 341 of ch. 11, title 31.

The bonds are sold at par in denominations of $50, $100, $500, and $1,000 and provide an investment yield of 3¾ percent per year, compounded semiannually. They bear interest from the first of the month in which the authorized issuing agent receives payment for them. They are issued in the name of the individual employee or owner on whose behalf they are bought. They may be distributed to the employees at any time; however, they are nontransferable and nonforfeitable and cannot be cashed until the individual: (*a*) is 59½ years old (insurance age 60) or before he attains the retirement age specified in the plan (if later than 59½); (*b*) becomes disabled; or (*c*) dies. The principal and interest on the bonds will be paid only upon redemption and will not be included in the bondowner's income until he redeems the bonds.

The bonds may be registered only in the names of natural persons in single ownership or beneficiary form, and they must be registered in the name of the self-employed person or the employee for whom they are bought. Bonds are reissued to add, eliminate, or substitute a beneficiary. They are also reissued if lost, stolen, or destroyed.

The use of these bonds could accomplish the same purpose as transferring an employee's retirement credits from one retirement plan to another, or to a central clearing agency (public or private) with less trouble and expense. If appropriate legislation were passed to tie in the redemption value of these bonds with the BLS cost of living index to protect their purchasing power against inflation, they could serve as a vehicle, not only for use in distributing vested pension benefits to terminated employees, but also for pension plan investment purposes. The machinery for the sale, registration, and redemption of these bonds is already in existence and operating.

5. *Evaluation of the alternatives*—

My own preference and recommendation is as before—that this be a voluntary, supplemental group annuity provided by the Congress as part of the OASDHI. There is no reason to duplicate the OASDHI files by encouraging a private corporation to provide the same service the Government is already providing. There is no reason to create a private corporation to do at greater expense what the Government can do less expensively. There is no reason to sell stock in a private or mixed public-private corporation to earn profits for anyone other than the beneficiaries of the pension trust funds; the important capitalization of such funds will come from the retirement contributions.

Bernstein's proposal that OASDHI also be a pension trust fund clearinghouse is most attractive. Private pension plans already in operation are not likely to go out of business in order to be replaced by an OASDHI voluntary, supplemental group annuity. There is, therefore, merit in his recommendation that Congress create such an account to receive the funds which would be due a worker upon his preretirement separation from employment. These credits would continue to earn interest, and grow with additional deposits the worker might make on his own account thereafter, together with other transfers upon the occasion of his separation from employment covered by other pension funds.

This would involve the acceptance of Father Harbrecht's proposal that the payments into a pension fund be treated as belonging to the

employee from the outset whether made by the employer, the employee, or both. Thus the workers who exercise their mobility would look to the supplemental OASDHI account while others would continue to look to their separate trust funds. Those workers who subsequently established rights under another fund would have both rights. Conceivably, one's final pension benefits might come to be based upon age, income at retirement, and total service under all retirement plans, less the amount of supplemental benefits earned in prior employments. This might actually serve to reduce the long-run total cost.

6. *Implementing the supplemental group annuities*—

The pension fund at the time of separation would simply report to OASDHI the name, age, and social security account number, and send along the dollar amount standing to the credit of the separated worker. These would be duly added to his supplemental record. If workers are premitted to make voluntary individual deposits, they should be nonrefundable, as Bernstein suggests, to avoid competition with banks, and so forth. He suggests, however, that in certified emergencies, workers might borrow against such funds just as they could borrow against many a personal life insurance contract.

Small groups might welcome the opportunity to buy such supplemental group annuities through OASDHI. These would be much more attractive to workers in the small plants where the problems of establishing adequate funds becomes too expensive for employers or employees to contemplate at the present on a group basis. It may be that millions of additional workers would avail themselves of voluntary, supplemental group annuities through such contracts.

It may also be that some existing plans would prefer to transfer their assets as credits to workers and go out of the pension management problem. Currently workers receive, for the Nation as a whole, wages of roughly $440 billions; all social security tax payments take another $25 billion; and health and welfare and pension plans take another $20 billion. The bulk of this latter sum is for term insurance, whether it be group life, health and accident, hospitalization and surgery or otherwise. The short-term insurance poses only a few of the problems that are raised by the pension plans. It may well be that some employers and some unions would welcome an opportunity to transfer the long-term pension obligations, recordkeeping, fund management, and so forth, to OASDHI. To facilitate this, the OASDHI supplemental group annuity plan would need to work out a suitable contract to accept future payments into the Government supplemental account while the existing assets of the existing trust funds were properly liquidated, with appropriate transfer of assets and liabilities, case by case, either to the supplemental account or by payment out to annuitants, thus providing a gradual expiration of the independent plans.

7. *Reexamine tax concessions for greater equity.*

The tax status of contributions to retirement purposes deserves renewed attention. Present tax law largely favors employer contributions only. The tax saving covers almost half of the employer's contribution. In many cases, the tax law gives no benefit to the employee contribution. Legislation does give some tax relief to the self-employed contributions toward retirement under certain circumstances.

At the minimum the tax law should treat both employer and employee contributions as deductible. The benefits, when received, should, of course, then be treated as taxable income. But the difference in tax rates would still favor employer rather than employee contributions. The evidence is that employers now put up $6 for each $1 put up directly by employees. Until the employee becomes conscious of the amount of the payments made (presumably on his behalf as a part of his income), the lack of employee contributions will continue to favor the denial to many of those presumably covered of the benefits they thought they were achieving under such plans.

Thus there may be merit in Bernstein's proposal to reverse the tax favor and to exempt the contribution made by the employee if it is a compulsory contribution, but to tax that made by the employer. This would certainly serve to build pressure for immediate and full vesting, full portability, and help protect the employee's interest because he would then see the contribution passing through his pay slip.

Tax laws now exempt the earnings by the pension funds as well as the contributions into them. With $135 billion already in the funds and the amount soon to reach $200 billion, this could easily mean an annual escape of as much as $10 billion of interest and dividend payments from the tax base. If and when the tax laws call this exemption into question, there may be reason to abandon the exemption or, if the Congress were to create a governmental voluntary, supplemental annuity account in OASDHI and wished to encourage but not to require its use, the Government could apply a tax differential between the earnings of private and public trust funds either as to contributions or as to earnings on the trust fund or both.

One other tax question relates to the taxation of payments to estates upon death. If the entire contribution plus the earnings thereon continue to be exempt from the income tax during the time the sums were accumulating, then the entire payment to any estate should be taxable under the income tax of the decedent for the year in which payment was made. Otherwise, such payments may be a permanent escape from income tax liability.

Conclusion

The Joint Economic Committee has very broad responsibility to help promote and maintain maximum employment, production, and purchasing power. This review of the impact of our present methods of assuring income protection to the elderly should lead to recommendations which not only promote their purchasing power, but also provide a better system of protection which helps assure maximum productivity and maximum employment. The goals of the Employment Act of 1946 are significantly inhibited by the plethora of private pension plans as presently constituted. The Nation's failure to deal competently with the changing nature of aging, and the failure to encourage older persons who are ready to continue working after the magic age of 65, 62, or 60, serves as a restraint upon maximum production, and upon maximum income, and upon maximum employment. It is a denial to the aged of their right to live fully, a denial the Congress would not contemplate for itself. Our society can be more productive, and more equitable in protecting its aged, through

making the changes suggested here. As the President has said, "Having the power, we have the duty." It is to be hoped that this duty will be more fully faced as a result of this investigation. It is to be hoped that the committee's recommendations which grow out of this study will lead to greater freedom, greater equity, and greater income assurance for the American people, in keeping with the great purposes of our Nation, and specifically those of the Employment Act of 1946.

INCOME FOR THE ELDERLY THROUGH WORK-LIFE EXTENSION, ASSET CONVERSION, AND PENSION IMPROVEMENTS

BY ROBERT TILOVE*

INTRODUCTION

If old age is not to be a period of deprivation and poverty for a large number of people, social measures will be needed to provide wide opportunities for work and more adequate retirement income through public programs and private plans.

It is realistic to expect that each individual will be able to provide adequately for his old age through his own savings, even if our economy were to provide reasonably full employment over a prolonged period of years. Too much uncertainty would still surround the economic life-cycle of the individual. Technological change and the dynamic quality of the economy may interrupt earnings or cut work-life prematurely short.

Our development into an urban and industrialized society has aggravated the problems of security in old age. It was once possible for an older person to work part-time on a farm or in a small business and to live as part of an extended family, sharing living costs and contributing economically. Now the generations live apart. Economic participation has increasingly shifted to an all-or-none basis—either full-time employment or no job at all. By shifting him from the farm or small town to the city, by reducing his opportunities for continued economic production, by separating him in a household apart from his children and grandchildren, modern work and living conditions have exposed the older workers to greater hazards of insecurity.

EXTENDING WORK-LIFE

Greater opportunities for work should be provided for older workers. There is a large pool of unused productive power among unemployed persons 55 and older who either lost their jobs or had to leave them because they were physically too demanding and who could not, with the handicap of age, find new ones. There are many who could do useful work accommodated to their reduced capacity, with great benefits to both their morale and their income.

There has been much discussion of job redesign to convert job content into something more suitable for older workers, much of it concerned with retaining employees who have grown too old for maximum efficiency on their existing jobs. However, the capacity and incentive for particular companies to do this sort of redesign is limited. Greater

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attention should be devoted to the possibilities for enlarging access to the types of employment, in whatever industry they may be found, for which older workers will be suitable. A clue to the answer might well be found in observing carefully the kinds of jobs that have been found by workers who rescued themselves from unemployment at 55, 60, or 65. The jobs they found may be in service trades rather than manufacturing and in small, rather than large, firms. The cases of successful employment may define for us the kinds of job adjustments that can be encouraged.

Another significant possibility for lengthening work-life lies in the development of "second careers". That term is not entirely apt; the word "career" implies a profession, but as used here, it is intended to refer to entry into a second type of work, not a second profession. What is involved is the possibility that a worker will be able to leave a physically demanding job while he is still in vigorous middle age and shift to a job at which he can continue to be productive into the middle and late sixties. That type of second employment is already a fact with career men in the armed forces and with police and firemen, where pensions frequently permit retirement as early as 40 or 45. Seamen have also won full pensions after 20 years of service and they will likewise have opportunities for shifting their employment to something they can more readily extend into their later years. Some truck drivers and driver-salesmen now have pensions which tend to provide the same opportunities.

These possibilities deserve earnest attention. It is often the case that a worker will continue at the job for as long as possible, until he is no longer able to keep up with it, and then find that he cannot get any other kind of work. A worker does that because he cannot afford to do anything else. However, given an opportunity and the wherewithal to make a change, there is no reason why the work a man does at 40 should necessarily be the work that he attempts to do at 55 or 60.

Would shifting into a second career be facilitated by benefits specifically designed to bridge the transition period, such as extra unemployment benefits, the costs of retraining, and the expenses of possible relocation? Would such benefits be more suitable than lifetime pensions after 20 or 25 years of service in encouraging change to another job?

As the standard of living rises, as higher levels of educational attainment are reached, as the work-week becomes shorter, and as continuing education for adults becomes more available, the prospects of "second careers" may become a major possibility for lengthening the work-life and earning capacities of the elderly. In time, the fact that a man or woman now has to cling too long to a job unsuitable for a person of 50 may come to be understood as the consequences of a "low" standard of living which left workers without the resources of time and money necessary to change to more enduring employment.

Converting Assets Into Income

A way should be developed for elderly persons to convert the equity they hold in their homes into lifetime income, without having to abandon their homes. It does not seem reasonable for an elderly person to have to get along on an inadequate income, while he or she holds a frozen asset that will be passed on to a child or other relative.

The 1963 Survey of the Aged by the Social Security Administration found that, among persons 62 years of age and older, two-thirds of the couples and one-third of the single persons owned homes and that their homes accounted for almost one-third of their total assets. The median equity in the home was substantial—$10,100 for couples; $9,070 for unmarried women; and $7,810 for non-married men.[1] These homes are generally held mortgage-free.[2] Among the third of the aged family units with the lowest income, more than 50 percent of the assets held were in home equity.

If home equities had been converted into life income it would have added 23 percent to the income of elderly married couples and 20 percent to the income of the non-married men and women.[3]

Certainly the homes owned and occupied by elderly persons do not become valueless upon their death. It should be possible to convert in advance most of the expected residual value into a life income. Life annuities might be paid in exchange for non-amortized mortgages representing most of the ultimate equity value of the home. New generations of elderly persons will have substantially greater assets available; a way of converting home equities into living income should therefore become a matter of increasing potential in making the aged financially self-sufficient.

Making Social Security Adequate

An adequate Social Security system is an essential basis for the economic security of the aged.

While private pension plan coverage has grown rapidly and covers a little over half the employees in private non-agricultural industry, there is a sharp limit to their ultimate extension. There are large segments of industry for which it is hazardous to predict the establishment of pension plans. Small employers and highly competitive, marginal enterprises may feel that they lack the ability to pay for pensions; if their workers are unorganized, they may never set up plans. In many industries, job turnover may make individual employer pension plans virtually meaningless. Without a union to force the establishment of an industry-wide arrangement, it is difficult to imagine an unorganized construction worker being covered by a pension plan. Employment conditions in agriculture would have to be revolutionized before pension plans could be considered there as realistic possibilities. In the absence of some radically new development, it is likely that by 1980 some 25 percent of all wage and salaried workers will still lack coverage by a private pension plan. Aside from the meager personal savings they may accumulate, the Social Security program will be their sole source of income.

Adequate Social Security is necessary for another reason. Proposals have been made for vesting and pension portability to protect the workers whose worklife is spread over several jobs. However, the more these proposals are elaborated—with full vesting, accrual of funds,

[1] Platky, L.D., "Assets of the Aged in 1962: Findings of the 1963 Survey of the Aged," *Social Security Bulletin*, November, 1964, pp. 3–13.

[2] Epstein, Lenore S., *Income Security Standards in Old Age*, U.S. Social Security Administration, Washington, D.C. 1963.

[3] Murray, Janet. "Potential Income from Assets" Findings of the 1963 Survey of the Aged"; *Social Security Bulletin*, December, 1964, pp. 344.

and compilations of lifetime records—the more they tend to re-establish the value of a Social Security system that grants benefits based on all covered employment. In short, improvement and extension of private pension plans will not be a substitute for an adequate Old-Age, Survivors, and Disability Insurance program.

In making OASDI benefits more adequate, major emphasis should be placed on avoiding the erosion of benefit levels because of changes in wage and price (cost of living) levels. The problem can be broken down into two categories. One is the matter of determining benefits, at the point of retirement, on the basis of current or recent wage levels. The other is maintaining the adequacy of benefits through the period of retirement.

The Social Security Act now provides that a worker earning $6,600 a year will be able to retire (some years in the future) on a pension equal to 30.5 percent of his average monthly pay and his wife will be entitled to 50 percent of his amount, making the combined benefit 45 percent of his average monthly pay. A worker earning $4,800 a year will be able to get a combined benefit (his wife and himself) of 51 percent of his average monthly pay. However, the plan will not work out that well, in terms of how his retirement income will relate to his pre-retirement earnings. There is a large discrepancy between the earnings of the average worker in the years immediately preceding his retirement and the average earnings over his entire work-life. In part, this is attributable to the better occupational position which the worker may have attained later on. Another part stems from the vast changes in general wage and salary levels over time, and simultaneously in the amount of wages taken into account in determining OASDI benefit amounts. A benefit calculated in relation to career earnings, even if it employs a fairly generous ratio, is likely to be inadequate in the light of wage and price levels at the time of retirement.

One remedy proposed has been to base OASDI benefits on earnings in the five- or ten-year period preceding retirement or on the five- or ten-year period of highest covered earnings. This may not work out as equitably or effectively as a formula which would—for purposes of computing benefit amount—revise earlier wage credits in proportion to the change in *general* wage levels from the year in which the employment occurred to the year preceding retirement. Such an arrangement would take full account of a lifetime of earnings, but adjust it to current conditions by correcting for changes in general wage levels.

For adequate protection against increases in the cost of living after retirement, an automatic cost-of-living adjustment should be provided.

Reluctance has sometimes been expressed about these changes because they would absorb the margins for improvement which rising wage levels (and contributions) will afford and therefore preclude other benefit changes that might be considered desirable at the time. However, that reservation is only a way of expressing some doubt about the merits of the proposed formula or about the care with which it might be embodied in the statute. Inflation is a process of partial erasure. Rising price and wage levels do tend to wipe out, partially, benefit rights built up on the basis of past earnings. If it is discovered later that a mistake has been made, the partial erasure is to be welcomed as an opportunity to turn the features of the program in a better direction. But if benefits have been well designed in the first place

and deserve to be protected from the erosion of rising price and wage levels, then they should be protected from partial erasure by soundly-conceived formulas for automatic adjustment.

Improving Private Pension Plans

Private pension plans cover at least half the employees of private non-agricultural industry; they have rapidly established successively higher levels of benefit and made liberal eligibility provisions. By 1980, private pension plans are likely to be paying out more than $9 billion a year for more than 6 million beneficiaries.

There are schools of thought that place little value on private pension plans. The report entitled *Old-Age Income Assurance: An Outline of Issues and Alternatives* submitted to the Subcommittee on Fiscal Policy of the Joint Economic Committee expressed the view that that aggregate of private plans was not well suited—from the standpoint of equity or efficiency—to accomplish the public purpose of providing adequacy of income in old age and that "one may suspect that the cost of the system to the Nation exceeds by a considerable margin the benefits to the aged." The viewpoint implied was that whatever private pension plans claim to accomplish in terms of public good could be accomplished better by a public program. Overlooked by that approach is the fact that what has been accomplished by employers and unions in supplementing Social Security with private plans was not accomplished, and might never be accomplished at all, through legislation. It also overlooked the value for a democratic, pluralistic, and dynamic society of arrangements that can be developed outside of government, on the initiative of employers and unions, and without depending on majority consensus.

Proposals have been made to regulate private pension plans by requiring vesting, more complete funding, and reinsurance to guarantee benefits in case of plan default.

Vesting—particularly after a substantial period of service—and adequate funding are both desirable goals from the standpoint of employees and of the public. Whether those steps should be compelled by legislation is another question.

Vesting.—Claims have been made that no more than 40 or 50 percent of the workers covered by private pension plans will ever receive a cash benefit from the plans because they will leave the employment covered before fulfilling plan eligibility conditions. These pessimistic estimates have not been supported by convincing evidence. Certain of these published conclusions have relied on general labor turnover figures—separation rates—and have calculated cumulative results over a period of years which seemed to establish that very few workers will remain in the same employment. General turnover rates are inappropriate for such findings. Even where employment is highly stable, a substantial turnover statistic can be generated by a few unattractive jobs that are filled by a succession of short-term workers. There have been other calculations which are one step more sophisticated. They recognize that turnover rates vary by the age of the workers and they therefore utilize turnover tables with specific rates for each age bracket and sex. From these it is possible to calculate the chances that a young man or woman will remain in a particular employment to retirement

age. The result is not difficult to predict—with any significant degree of turnover the result is a high probability that a young man of 25 will not be in the same employment when he is 65.

Those findings have a certain plausibility but they are nevertheless inappropriate. The real question is not the probability that a young man or woman will remain with the same employer to retirement age but rather the following: what percentage of the older worker population is covered by pension plans and will be eligible for pension benefits?

The distinction can be well illustrated by an actual example using a group with comparatively high turnover—the unlicensed seamen on the East and Gulf Coasts. If we apply the successive turnover rates which have actually occurred in a projection applied to seamen who are 27 years of age, we find that no more than 13 out of 100 will be sailing by the time they are 65. This is the kind of figure that has been used to establish the idea that pension plans are a "mirage". However, if we look at the seamen who are 60 or over, we find that 71 percent have accumulated the 10 or more years of service required for eligibility. These figures are by no means in conflict. If we start at a comparatively young age, the cumulative attrition is high. When we look at the situation of the older worker, we see that the great majority is eligible for pensions. These two answers are reconcilable if we recognize that turnover rates are high in the younger age brackets but they go down soon enough so that older workers do, in most cases, accrue pension eligibility.

However, the observation that the great majority of older workers covered by pension plans will fulfill their eligibility requirements does not entirely resolve the question. The objection can still be raised that these older workers represent a select population, the survivors of a process of attrition, and that what is missing from the picture is the ultimate fate of the workers who left that employment.

However, that objection only raises a further question. When a worker leaves an employment in which he is covered by a pension plan, where does he go? The analyses to date seem to have assumed that he went to another employment where there was no pension plan. That assumption is unwarranted. Presumably, there is at least a 50–50 probability that his next employment is covered by a pension plan and, since most turnover occurs before age 40, he will still have adequate time on the new job to become eligible for a pension. One might argue that the chances are even better that he will wind up under the protection of a pension plan on the theory that as he changes jobs he will move into more stable employment in which there is greater-than-usual prevalence of pension plans. On the other hand, the claim can be put forward that the process of turnover results in the accumulation of middle-aged workers in undue proportions in low-standard industries in which there are few pension plans. That argument would have persuasiveness if it were true. However, no facts have been produced to that effect.

Whether private pension plans are an illusion or provide valuable benefits is amenable to a simple answer. At the present time, private pension plans hold assets worth close to $100 billion. Since most plans are not yet fully funded, the benefit rights accrued under the plans by virtue of employee service in the past are worth (that is, have a

present actuarial value) considerably in excess of $100 billion. In other words, *after discount* by their actuaries of the forfeitures of benefits which will occur as the result of job turnover, these plans have built up benefit rights worth more than $100 billion.

There is no question but that to the industrial worker who loses out on pension benefits because of job changes, voluntary or involuntary, the loss is real and significant. It remains of some importance whether these cases are 15 percent of the workers covered by private pension plans, 50 percent, or 75 percent.

Vesting provisions have become significantly more extensive. In 1952 only 25 percent of union-negotiated plans had any sort of vesting provisions. By the winter of 1962–63, two-thirds of all pension plans provided vesting, and they covered 60 percent of all workers covered by pension plans.[4] The requirements are 10 or 15 or 20 years of service, frequently joined to a minimum age requirement. Approximately a third of all workers covered by private pension plans would qualify for benefits if termination occurred after they had attained 15 years of service and age 40.

These vesting provisions are in addition to early retirement provisions, which are today common practice and generally make benefits available by age 55. Also, evidence indicates that the spread of vesting has been accompanied, particularly in recent years, by a trend toward more liberal eligibility rules. For example, the proportion of "pattern" or negotiated plans studied by the Bankers Trust Company that permit an employee to vest fully at age 40 with 15 years of credited service increased from 42 percent in 1957 to 75 percent in 1965. Among "non-pattern" plans, the increase was from 21 percent to 33 percent.

Industrywide or multiemployer pension plans, which provide about 20 percent of total pension coverage, add another element of protection for workers who change jobs—continuity of pension covereage if the worker shifts from one job to another within the scope of the multiemployer plan. In effect they provide immediate and full vesting to any worker under their coverage, provided the shift is to a covered job. Since these plans generally cover a whole industry or craft within a city or region, they generally provide continuity of pension accrual for a large proportion of the job changes that are likely to occur.

Reciprocal or integration agreements between industrywide plans is another development which has enlarged the area of protection for a worker in the event of a change in jobs. Under these agreements, two or more multiemployer plans will agree to reciprocal recognition of employment credits as the basis for qualifying workers for their pension benefits. So, for example, in the maritime industry, a ship's officer can switch from the East Coast to the West Coast or vice-versa and be assured of continuity of pension credits.

The essential problem with legislating vesting is that it would impose a cost on a pension plan at a time when the employer and the union might consider—and perhaps rightly—that other claims to the resources available to the plan should take priority. Pension Plans have gone through successive stages of development. Their first emphasis was on benefit amounts for workers facing immediate retire-

[4] U.S. Bureau of Labor Statistics, *Labor Mobility and Private Pension Plans*, Bulletin No. 1407 (June, 1964).

ment. Then they branched out into disability pensions, early retirement, survivors' benefits, and now vesting. Compulsory vesting would take all pension plans, regardless of their age, their resources, and the other demands upon them, and create a priority for vested benefits.

A possible source of inequity lies in the fact that industry-wide plans might be required to provide vesting after 10 or 15 years of service with a particular employer, when they already provide full immediate vesting to a worker who is shifting from one employer to another within the scope of the plan. In essence, they now bear a cost for vesting in the event of intra-industry transfers. The vesting proposals do not take this into account as a credit toward the suggested vesting requirements.

It might be a good idea for proposals for compulsory vesting to be framed so that the requirement were contingent on the level of benefits, so that such a requirement would not cut down on the resources available for improving benefits that are as yet meager.

Compulsory vesting would have far-reaching effects on pension plans. Difficulties in defining what is to be vested would lead to fairly elaborate rules. The question has to be asked: "Require vesting of what?" The report of the President's Cabinet Committee and various other proposals have seemed to assume that every plan has a normal retirement age (such as 65) and that the benefit is, in one way or another, a certain number of dollars per month or a certain percentage of pay for each year of service. That is not necessarily true. Suppose a plan pays a flat benefit of $50 a month starting upon retirement at 65 or later, if the worker had at least 15 years of service in the period preceding his retirement. How would compulsory vesting apply? Does this mean that a worker who has acquired 15 years of service by age 35 has acquired a vested right and is entitled to benefits deferred to age 65? If this is what it means, then a worker covered by plans of this kind may, under some circumstances, acquire two full pensions in one working lifetime, since there is certainly nothing uncommon in 40 or 45 years of total employment.

Take another example: there are some plans in the maritime industry and others that pay full benefits regardless of age after 20 years of service. Is this to be vested too? Does this mean that somebody with 15 years of service would automatically be entitled to a partial pension regardless of age? It is doubtful that that was intended by the proposal. That means that a retirement age would have to be spelled out.

There are further difficulties in defining what benefit is to vest, if it is mandated. It is becoming a little difficult to say what the normal retirement age is, that is, to what age the benefits of a plan are keyed. The automobile industry agreements provide the same benefits at age 62 as they do at age 65 (and in fact higher benefits for workers who retire before 65 because of layoff or by mutual agreement). The only exception is for somebody who left employment with vested rights—if he wants to claim a deferred pension starting at age 62, it is in a reduced amount based on his being three years younger than 65. What is the normal retirement age in such a plan? Is it 62 or 65? What gets vested if vesting is compulsory, an age 62 pension or an age 65 pension? Except for their vesting provisions, the automobile industry agreements actually provide for a normal retirement age of 62. Cer-

tainly a compulsory vesting law could not allow the vesting to be fixed by a decision of the parties to the plan that they vest what they want to vest. If it has any meaning they would have to vest some part of the benefit payable to a worker who retires normally. Would that mean that the automobile pension plans would have to vest the full benefit amount payable from age 62?

If vesting is to be mandated so as to assure a worker retirement income despite changes in jobs, then it should take account of the fact that a full working lifetime is closer to 35 or 40 years than it is to 20 or 30 years. An appropriate formula of what is vested under a compulsory statute would be, for each year of service, one-fortieth of the maximum benefit provided under that plan for a person of 65.

It should be recognized that pension plans have been designed to cover long-service employees—and almost always on the assumption that they would not also have available benefits based on relatively short service elsewhere before or after. With compulsory vesting, this assumption would no longer hold and provisions for vesting benefits should logically contemplate the entire span of work-life during which vested rights could be acquired.

Funding.—Proposals for required funding are subject to some of the considerations pertinent to the proposals for compulsory vesting. The objective is in general, desirable. Pension plans are in fact far along toward accomplishing the goal of adequate funding. A study as of 1964 of 75 of the largest plans in the country found that their assets were 69 percent of their accrued liabilities.[5] This was an impressive degree of funding, in the light of the liberalizations which had been made in these plans in the preceding years. To compel adherence to a funding schedule would represent an enforced order of priority that would cut down on what new plans or plans with limited resources could do in the way of immediate benefits. At what point does social policy dictate that an adequate schedule of funding takes priority over the other claims? A classic case perhaps is that of the national pension fund for bituminous coal miners, which provided a pension of $100 a month financed out of a cents-per-ton royalty contribution. Through a combination of circumstances, including a drop in tonnage mined, the contributions proved inadequate to sustain the $100 pension level and it had to be cut back for a period of time to $50. With a fuller schedule of funding, a cutback might have been avoided, but by the same token the fund would never have gotten started with payments as high as $100 a month. The question is whether social purpose would have been served by requirements for funding which would have limited the level of miners' pensions from the very beginning to less than $100 a month.

Another consideration affects industrywide plans. An industrywide plan typically undertakes a unique funding obligation, namely, the obligation of fulfilling benefit rights in the event that a particular contributing employer goes out of business. Fulfillment of that undertaking is an everyday occurrence. Numerous employers have gone out of business without any damage to the ongoing pension credits of their employees, where they have been covered by industrywide plans. So long as the former employees continued to work within the industrial or craft scope of the industrywide plan, they have been made

[5] Joseph Krislov, "A Study of Pension Funding," *Monthly Labor Review*, June 1966, pp. 638–642.

whole on their ultimate pension rights. Fulfillment of pensions in the face of business turnover represents an implicit cost to these plans, a cost which represents a margin otherwise applicable toward fulfilling a schedule of full funding.

Reinsurance.—The general idea of reinsurance to fulfill pension promises in the event of default by the plan is attractive, but its feasibility has yet to be established. Comparisons to savings or mortgage insurance are not convincing. The risks which reinsurance of pension plans would have to cover including the following:

1. The risk that the company will go out of business. This might include the risk that a company might elude its commitment to a pension plan in connection with a merger or sale of assets.

2. The risk that the assets of the pension fund might depreciate. It is a common practice for 30 percent to 50 percent (sometimes more) of the assets of a pension fund to consist of common stock. Unless a reinsurance proposal involved the elimination of common stock as a pension fund investment it would have to undertake to fulfill the dollar commitments of the plan even if the common stock depreciated. The question is most spectacular in the case of common stock, but of course the possibility of depreciation could also apply, to a lesser degree, to preferred stock, bonds, and mortgages. Unless the types of securities which a pension fund might acquire were to be severely regulated, the reinsuring institution would have to be prepared either to charge a uniform premium, no matter what degree of risk the securities represented, or charge a differentiated premium based on a valuation of the degree of risk embodied in a specific portfolio.

3. The risk that the actuarial assumptions on which the projection of benefit commitments were calculated proved erroneous. Turnover, mortality, salary changes, age, patterns when retirements take place, investment yield, are likely to prove different to some degree from what was assumed. An undertaking to fulfill the benefit commitments would involve in essence a coverage of this risk as well as the others.

Security of investments.—It is possible for the assets of a pension fund to be invested in ways that take undue risk with the interests of the beneficiaries. The great majority of pension plans are invested responsibly in ways intended to serve the interests of the beneficiaries. There may, however, be cases where self-interest on the part of those who manage a pension fund leads to undesirable investments. We do not know how many cases of that kind there are; present federal disclosure regulations do not require that individual investments be reported, except where direct self-interest is involved. A pension plan can make an unusual or questionable investment and even one in which there is some element of self-interest because of the potentiality for corporate control or interest, and yet not be required to disclose that transaction under present reporting requirements. For example, if a large amount of the stock of Company A is bought by Company B's pension fund in order to influence a proxy fight or to effect a merger or as part of some sort of reciprocal business arrangement, it would not have to be reported at the present time.

It would serve a useful purpose if unorthodox investments were subject to disclosure. It would give the public and the affected employees knowledge to which they are entitled and it would tend to impose restraint on those responsible. This could be accomplished if every pension fund were required to file an inventory of its portfolio and transactions. The difficulty with this proposition, however, is that it would accumulate a mountain of paper, 90 to 99 percent of it from plans which hold diversified portfolios invested in well-known blue-chip stocks and bonds and insured or conventional, high-quality mortgages.

It would seem possible to pinpoint disclosure so that only the extraordinary investments are regularly disclosed. For example, annual disclosure requirements could be made to apply to:

1. Any purchase of a bond or stock not listed on the New York Stock Exchange, except for shares in a major bank, major insurance company, registered investment company, or a common trust fund.
2. Any investment in a single security in an amount exceeding 5 percent of the total pension fund (provided it is at least $500,000).
3. Any holding of common stock representing more than X percent—such as 5 percent—of the total outstanding common stock of the company.
4. Other classes of ordinary investment (such as insured mortgages) could be defined for nondisclosure, so that disclosure would apply only to the extraordinary.

Fiduciary responsibility.—The moneys accumulated in a pension plan can be used legally only for the benefit of the employees covered (and their survivors and/or beneficiaries), including, of course, the reasonable expense of establishing and maintaining the plan. The only exception is that funds ultimately found unnecessary for the fulfillment of the plan may be returned to the employer. In short, the objective of preserving the funds for the exclusive benefit of the employees is already embodied in law.

These funds are accumulated either under an insurance contract or in a pension trust. The insurance contracts are subject to supervision by state insurance departments. The pension trusts are governed by agreements or declarations of trust, which make pension (and related) benefits the exclusive purpose of the trust.

Trustees are generally held to a high standard of accountability; they are held liable not only for misfeasance but for negligence and for failure to exercise prudence. Some pension trust agreements have exculpatory provisions, which seek to limit the liability of the trustees, but there is doubt about their effectiveness.

There have been cases in which trustees for large pension plans, covering thousands of employees, have engaged in acts which might expose them, as trustees, to civil suit and yet no one has sued them. The answer lies in the fact that those entitled to enter suit are employees and pensioners, without the resources for legal action, and their interests are diffuse. If the trustees of a pension fund with $50 million in assets make an imprudent investment that results in a loss of $500,000, how much is an individual employee or pensioner affected?

These considerations argue for legislation to empower a government agency to enter suit to enforce the fiduciary responsibilities of trustees and others handling pension funds.

In summary, the economic security of the aged can be advanced by extending their work-lives through continued employment and greater opportunities for reemployment, by measures to permit conversion of frozen assets into income, by changes in the OASDI program that would automatically keep benefits in line with changing wage and price levels and by measures helping to assure the growth and fulfillment of private plans.

ROLE OF PUBLIC AND PRIVATE PROGRAMS IN OLD AGE INCOME ASSURANCE

BY JOHN McCONNELL*

In 1938, Reinhard A. Hohous wrote a masterful statement of the problems of adequacy and equity as related to social insurance and private insurance protection.[1] It was his contention that social insurance must place the highest priority on adequacy of both coverage and benefit payments, and secondary priority on questions of equity. In private insurance, he argued, equity is paramount—costs should be allocated according to risk, coverage may be limited by the decision of an individual to accept or reject insurance, and the benefit can be related to the individuals "need for, and his ability to afford, protection * * *".[2]

Much of the continuing controversy regarding coverage and benefit payments in the federal old age insurance system is related directly to a failure to understand, or an unwillingness to accept, the fact that OASDI is social insurance, created to combat the widespread and persistent problem of dependency in old age. Hence, adequacy of coverage and benefit payments must be a primary objective. Quite proper efforts to include some features of equity in the Old Age Insurance system have nevertheless from the very beginning confused the social insurance role of OASDI. These features, such as relating benefits to earnings, coverage as an attribute of private employment and payment of benefits as a right earned by prior employment, desirable as a reflection of American ideals, *have undoubtedly* aided and abetted those who test the effectiveness of the federal old age insurance system against the principles of equity as found in private insurance.

The original social security bill did give priority to questions of adequacy in the program for older people. Benefits it said should furnish "a reasonable subsistence compatible with health and decency."[3] Coverage was broadly conceived. All occupations were included except public employment and railways for whom other public retirement systems were in effect or proposed. No exemptions were made for agricultural workers, domestics or employees of non-profit organizations. Nor was the size of the employing unit grounds for exclusion.[4] That the Act itself as finally passed by Congress, limited coverage and severely restricted the level of benefits is attributable to considerations of financial exigency; administrative problems; and the determined efforts of powerful pressure groups to achieve exempt status for certain occupations. During the past thirty-two years since the passage of

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[1] Reinhard A. Hohous, The Record, American Institute of Actuaries, June 1938.
[2] Ibid.
[3] H.R. 4142 and H.R. 7260; S. 1130; Paul H. Douglas, Social Security in the United States, New York, 1936, pp. 87–89.
[4] P. H. Douglas, Social Security in the United States, New York 1936, pp. 87–89.

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the Social Security Act, revisions have sought to fulfill the conditions of a viable social insurance system for older Americans. This goal has not yet been achieved.

Adequacy with respect to coverage can be precisely defined. All permanent residents of the United States should be assured protection against dependency in old age. Despite minor questions which have given rise to controversy, for example, extent of attachment to the labor force, citizenship and the specific age when one becomes old, insurance protection for the aged is now extended to virtually everyone in the United States when he reaches the age of sixty-two.

The record of expanding coverage of OASDI is truly impressive. In 1941 about 55 percent of the labor force was in covered employment, and 10 percent of all persons over sixty-five were receiving or were entitled to benefits. By 1965, 97 percent of the labor force was in employment covered by a public retirement plan and 92 percent of all persons over sixty-five were receiving or were entitled to benefits. In addition, benefits could be claimed at sixty-two by covered employees and their wives. More important, 98 percent of all persons under age sixty-five could confidently expect to receive old age insurance benefits when they reached old age.

The definition of adequacy with respect to old age insurance benefits is not nearly so clear cut as for coverage. Moreover, the role of OASDI, in providing income for older people has been severely challenged by (1) the proponents of private pension plans, and even more important by (2) those who claim that because of social insurance principles too large a proportion of the nation's transfer payments now go to those older persons who are not and are not likely to become dependents, while millions of children, widows and the disabled in younger age brackets are very poorly provided for.

If the old age insurance system were to provide benefits which would furnish "a reasonable subsistence compatible with health and decency" what would the scale of benefits be? This is indeed a thorny question. Regional differences regarding living standards and individual variations in need are barriers to agreement with respect to a minimum adequate income. Two yardsticks are at hand: (1) The Social Security Administration has defined poverty as annual income of less than $1,500 for a single person and about $1,900 for a couple;[5] (2) family incomes providing for a modest but adequate budget for families of varying sizes have been calculated by the United States Labor Department after extensive field studies in a score of American cities. The latest revision would establish the desired income for an aged couple of $2,400.[6]

Using the lower of the two yardsticks, the poverty level index, in 1966 only 25 percent of all aged beneficiaries have incomes above the poverty level if OASDI benefit income is omitted, but 36 percent more are kept above the poverty line by the OASDI benefit income.[7] It would require an expenditure of $2.2 billion annually to

[5] *Social Security Bulletin*, January and July 1965; April and May 1966, United States Department of Health, Education and Welfare, Washington, D.C.

[6] United States Department of Labor.

[7] Ida C. Merriam Social Security Benefits and Poverty, Research and Statistics Note No. 6, 1967. Table 3, p. 11, United States Department of Health, Education and Welfare, Washington, D.C.

raise the income of the remaining 39 percent to the poverty line.[8]

The increases in OASDI benefit levels in 1965 and 1958 were less than the increases in the cost of living during the intervening periods. At the present time even a 15 percent increase in benefits would leave 29 percent of the aged individuals or couples below the poverty line.[9] The primary cause of low benefit levels appears to be the low level of prior earnings of so many of those currently receiving benefits. Hence, in order for OASDI to provide incomes high enough to lift four million older persons and couples above the poverty line a minimum benefit of $100 per month would be needed.

When the Social Security Act was passed, the purpose of old age insurance was said to be the provision of a floor of income support. It was expected that individual savings would supplement the basic OASDI benefit. Following the rapid expansion of private pension plans during and following World War II, it became quite common for both the proponents and opponents of old age insurance to refer to the American system of income maintenance as a three legged stool, or a three layer cake, although the pitiful nature of the income received by most older people from all sources made the analogy of the cake seem something of a mockery. It is quite clear that the spread of private pension plans has confused the roles of OASDI and of private pensions and savings. There is a tendency to argue that OASDI should provide only minimum subsistence, and that private pensions will supply enough when added to OASDI to equal an adequate income. Private saving will assure a comfortable existence. This view of the three elements is reflected in the formulas used to determine the amount of private pension benefits, since the private benefit is superimposed on the OASDI benefit to fulfill the popular formula which yields 65 percent of average wages for the low income group scaled downward so that combined benefits will yield 50 percent to 35 percent for the various gradations of the high income group.

It is unfortunate that this policy has received such wide support since only about 15 percent of all older people receive a private pension. If allowance is made for 50 percent of the beneficiaries being married the percentage is still only a little over 20 percent of all persons over sixty-five [10] who benefit from private pensions.

There has unquestionably been a phenomenal growth in persons covered, size of benefit payments and number of beneficiaries of private pension plans since 1950. The rate of growth has been declining rapidly, however. The growth rate from 1950–55 for coverage was 9.5 percent, for beneficiaries 16.8 percent; the corresponding figures for 1960–64 were 3.8 and 8.8 respectively. Coverage increased by one million workers between 1964 and 1965 but the percentage of the labor force covered remained the same, 46 percent.[11] At current rates

[8] Wilbur J. Cohen, Improving the Status of the Aged, Social Security Bulletin, December 1966, p. 4, United States Department of Health, Education and Welfare, Washington, D.C.

[9] See reference No. 2.

[10] Alfred M. Skolnick, Ten Years of Employees Benefit Plans, Social Security Bulletin April 1966, p. 11, U.S. Department of Health, Education and Welfare.

[11] Alfred M. Skolnick, ibid; Walter W. Kolodrubetz, Private Employee Benefit Plans in 1965. Research and Statistics Note No. 7, 1967, U.S. Department of Health, Education and Welfare, Washington, D.C.

of growth approximately half the labor force will not be covered by private pension plans in the foreseeable future and apparently the population over sixty-five is now increasing faster than the number of beneficiaries—by the order of about three to two.

In the face of these somewhat elementary facts about the income of older people, it is impossible to assume that the population sixty-five will generally received an *adequate* retirement income through a combination of OASDI and private pension benefits. Faced with the prospect that not more than 20 percent of those over sixty-five (25 percent of all beneficiaries of OASDI) will receive private pension benefits, if the nation is serious about providing an adequate income for older retired people it will have to do so through a greatly improved public old age insurance system.

The cost of bringing all persons and couples sixty-five and over up to the poverty line, i.e., $1,500 per single individual per year, $1,900 per elderly couple, has been estimated at $2.2 billion annually. With an annual increase in productivity and in real disposable income estimated at 3.5 percent [12] it is obvious that the nation can afford this improvement, but there is the question of whether in the face of all other needs additional funds should be spent on older people. Numerous economists have proposed the introduction of some form of needs test to reduce the cost of old age benefits, using the saving to improve the well being of dependent children, widows, and the sick and disabled. A decision on such an issue is most difficult, but there are other ways of reclaiming insurance benefits received by those who are above the economic support line, for example, taxing OASI benefits attributable to the employers contributions which would not undermine the contributory character of the OASDI System. There is a great deal to be said in support of finishing the job of providing adequate income for all older people using the present system. This goal is now within sight.

The specific mechanism for adding $2.2 billion to the OASDI benefit payments is an important tactical matter. In the early days of the old age benefit program, it was recognized that benefits payments to those at the point of retirement would have to be paid for by funds other than their own contributions and those of their employers. While it was generally agreed that these costs should be paid from general revenues the specter of an unmanageable reserve led to the decision to pay the current retiree benefits out of the reserves accruing from the contributions of younger workers, with the understanding that a government contribution to current benefit payments would be made in the future.[13] It has, therefore, been proposed that the higher minimum be paid not from the OASDI reserve but from general taxes.[14] In the light of the past history of old age benefit finance, this appears to be a reasonable proposal.

In summary, then, the goal of adequacy has been achieved in OASDI coverage but not in income levels. OASDI benefits are the main source

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[12] Council on Economic Advisors Economic Report to the President, January 1967, p. 41–43, Washington, D.C.

[13] Douglas, P. H., Social Security in the United States, pp. 59–60, New York 1936, Ball, Robert M., Address before American Society of Public Administration, Washington, D.C., April 14, 1966.

[14] Seidman, B., The Case for Higher Social Security Benefits, American Federationist, January 1967, Washington, D.C.

of income for 85 percent of all older people while but 15 percent receive private pensions. Present trends indicate that private pensions can at best be a welcome supplement to OASDI benefits for only a small proportion of all older people. Adequacy of income can be achieved at reasonable cost by a general increase in benefit levels and the establishment of a minimum benefit high enough to provide adequately for those whose lifetime earnings have been too low to claim an adequate benefit under present benefit formulae.

SOME REFLECTIONS ON SELECTED ISSUES IN SOCIAL SECURITY *

BY ROBERT M. BALL **

INTRODUCTION

There was a time, back 10 or 15 years ago, when many of us were quite concerned that social security was not attracting as much interest from the academic and other research communities as we believed it deserved. I think those times have passed. It is very encouraging, as well as very important to the country, that an increasing number of scholars are devoting time and attention to social security issues, as evidenced by the contributions to this Compendium.

During the past few years there has been an increasing tempo of discussion about the social security system, welfare programs, private pensions and other fringe-benefit arrangements and related programs and proposals. In this paper I will comment on some of the discussion that has been taking place about social security.

I would like to begin by making a point that tends somewhat to be overlooked in our search for ways to improve. The point is that our national social insurance system as we have it today—with all the need there is for improvement—is right now a tremendously sucessful program, which has changed the face of America in one short generation. Twenty-four million people who would otherwise be among our most economically vulnerable group—the retired aged, widows and orphans and the totally disabled—have income they can count on month after month as a matter of right. That this has been accomplished with the enthusiastic acceptance of the vast majority of Americans speaks well for the principles on which the program is founded. These principles have not only been widely accepted but have stood the test of practical operation for a generation.

Economic security for the American people has radically improved from just 30 years ago, when few had pension rights of any kind and few had continuing income protection for their families in case of death of disability, to the situation today when just about all have pension rights and when the face value of survivors insurance alone under social security is $940 billion. Yet the methods used have been anything but revolutionary; rather they are built on traditional values and concepts—self-help, mutual aid, insurance, incentives to work and save. To bring about such a great social change with a minimum of disruption, using traditional ideas and motivations, is the ideal approach to social reform. Social security, having taken this approach,

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* Adapted from the "Concluding Remarks" at the Princeton University Symposium on Social Security, June 1967. Symposium papers will appear soon in *The American System of Social Insurance* (McGraw-Hill).

** Commissioner of Social Security.

is our most successful experience in recent times with a planned and deliberate effort to bring about a major and permanent social reform.

General Goals and Objectives of Social Security

Let me summarize the principles on which this accomplishment is based. The most succinct of recent statements summarizing the principles and purposes of social security that I know of is in the introduction to the Advisory Council Report of 1965. I quote the statement at considerable length because I don't know how to improve upon it as a description of the principles underlying the American program.

"The Council strongly endorses the social insurance approach as the best way to provide, in a way that applies to all, that family income will continue when earnings stop or are greatly reduced because of retirement, total disability or death. It is a method of *preventing* destitution and poverty rather than relieving those conditions after they occur. And it is a method that operates through the individual efforts of the worker and his employer, and thus is in total harmony with general economic incentives to work and save. It can be made practically universal in application, and it is designed so as to work in ongoing partnership with voluntary insurance, individual savings, and private pension plans.

"Under the social security program the right to benefits grows out of work; the individual earns protection as he earns his living, and, up to the maximum amount of earnings covered under the program, the more he earns the greater is his protection. Since, unlike relief as assistance, social security benefits are paid without regard to the beneficiary's savings and resources, people can and do build upon their basic social security protection and they are rewarded for their planning and thrift by a higher standard of living than the benefits alone can provide.

"The fact that the program is contributory—that employees and self-employed workers make contributions in the form of earmarked social security taxes to help finance the benefits—protects the rights and dignity of the recipient and at the same time helps to guard the program against unwarranted liberalization. The covered worker can expect, because he has made social security contributions out of his earnings during his working lifetime, that social security benefits will be paid in the spirit of an earned right, without undue restrictions and in a manner which safeguards his freedom of action and his privacy. Moreover, the tie between benefits and contributions fosters responsibility in financial planning; the worker knows that improved benefits mean higher contributions. In social insurance the decision on how to finance improvements is always an integral part of the decision on whether they are to be made.

"Because of these characteristics of social insurance the Council believes that where it can be properly applied it is much to be preferred to the method of public assistance, with its test of individual need, and the Council therefore strongly favors the improvement of social insurance as a way of reducing the need for assistance. The Council recognizes the need for an adequate public assistance program, but it believes that assistance should play the role of a secondary and supple-

mental program designed to meet special needs and circumstances which cannot be dealt with satisfactorily by other means.

"No matter how well designed and administered, assistance has serious inherent disadvantages in terms of human dignity and incentives to work and save. People view receipt of assistance as meaning a loss of self-support. In contrast, they view social insurance as an extension of self-support. People who had led productive lives and have supported themselves through their own efforts do not want to see their self-reliance end with their ability to work.

"Moreover, applying for assistance is at best a negative experience. Eligibility for assistance depends upon the individual's asking the community for help and proving that he is without the resources and income to support himself and his family. On the other hand, under social insurance the individual proves, not that he lacks something, but that he has worked and contributed, and has thus earned a right to a benefit."

Like the United States Constitution, these principles allow for much leeway in interpretation and application. But they are fundamental; they have a strong appeal everywhere. People like to earn what they get and they like to have other people earn what *they* get. The relationship to work explains much of the great strength of contributory social insurance.

I do not believe at all, as some have evidently come to believe, that the difference between people's attitudes toward an income-determined or needs test program and social insurance is primarily a matter of "style of administration."

Although I believe we should do everything we can to make the needs test less onerous and to make an assistance or income-determined program as considerate of individual self-respect as possible, it is not in the nature of people to feel as comfortable about receiving money payments because they can prove that they otherwise lack enough to live on as they feel when they get money payments in return for work and contributions.

Universal Coverage

Today, 9 out of 10 jobs are covered under social security, including the Armed Forces, the self-employed, the farmer, the farmworker, and just about everyone except certain Government employees covered by separate systems. About 90 percent of all people 65 and over are protected under the program and 95 out of 100 mothers and children in the country would be entitled to monthly benefits in the event of the death of the main breadwinner in the family. Nearly 90 million people will contribute to the system during 1968.

Although in Europe social insurance started out as a program for low-income people, in the United States from the very beginning it has applied without regard to the amount of one's earnings. That is, the first $7,800 of earnings for everyone is covered under the system. Our social security system is therefore not primarily a poor man's system but is also of great importance to people at all income levels—middle-income people and those with more than average income as well as the poor.

The fact that this is increasingly true has been brought home to me by the reaction that I now get in talking to audiences of businessmen

and executives, as compared with the reaction from such groups in the 1940's. In those days the questioning made clear that the audience was interested in the program almost entirely from the standpoint of social policy; their questions related in a very impersonal way to the nature of the institution and what it might do for others. Today, a high proportion of the questions from such a group show clearly that they are interested as well, and frequently perhaps more interested, in what the system will do for them as individuals—how much will they have to pay and what will they get; and almost all have a question about some friend or acquaintance of theirs who had this or that social security problem. With one out of every nine Americans getting a benefit every month and just about everyone else insured for future benefits, this is the one Government program of personal interest to practically every American family.

Our system, then, is universal in coverage, serving as basic protection for just about everyone. It is a system for the supervisor, the executive, the farmowner, the businessman, the skilled worker, as well as the unskilled. But it is also a system for the very low-income person; it just is not true, as has sometimes been implied, that the program leaves him out or treats him badly. In fact, in relation to contributions paid, the system does the most for the lowest paid.

Social Security and the Prevention of Poverty

Social security has been our most effective weapon in the war on poverty to date. It has made the difference between being poor or not poor for more people than all other programs combined. Following the increase in benefits resulting from the 1967 amendments, we estimate that nearly 10 million people are kept out of poverty because they are getting social security benefits. About 7.5 million beneficiaries, while still below the poverty line, are primarily dependent on social security.[1]

Only about a fourth of the beneficiaries have incomes sufficient to keep them above the poverty level without social security benefits. And for a high proportion of this group, the source of income that makes the difference is continuing earnings from someone in the family—income which in the case of older people will stop on retirement. There are many people in this group, too, who, sooner or later, will be looking to social security benefits to keep them out of poverty.

We have, then, a system of universal usefulness, relied upon by people at various income levels; at the same time, a very high proportion of the people drawing the system's benefits would be below the poverty line in the absence of these benefits.

Emerging Issues in Benefit Structure

The social security program was designed from the beginning to play a major role in the prevention of poverty among low-income workers. There has always been a weighted benefit formula favoring those with long earnings. The theory was that although benefits should

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[1] These estimates are based on the Poverty Index developed by the Social Security Administration which indicates, for example, that a person aged 65 or older living alone now needs $1,600 a year and an aged couple about $2,000 a year to remain above the poverty level.

be essentially wage-related—giving higher benefits to those who earn more and pay more—nevertheless, the replacement of past earnings should be at a higher percentage for low earners than for middle and high earners. If this had not been done, quite clearly, the program would not have served the interests of the low wage earner. He would have been asked to pay toward his protection but benefits for him would have been so low as to require supplementation from the assistance programs. Wage-related social insurance systems throughout the world have made special provision for the low-paid worker.

This approach can certainly be questioned. If one were to design a transfer system solely to deal with poverty—if nothing else were involved but this one issue—one could well question whether low-paid wage earners should be asked to contribute toward their own protection and whether from the standpoint of their income position they might not be better off in a separate program that paid them income-determined benefits from general revenues. But there are deep-seated values in the tradition of self-help and earned rights that support the independence of the beneficiary and the security of the payment and that cannot be gained in any other way. Even further, I think one can generalize beyond this to say that to the extent possible the poor are served best when served by the same institutions as the rest of the community rather than separately. Sometimes separation is necessary, but I would argue that for the sake of the poor we should avoid it where we can. Our interest, as individuals and as a people, in institutions that we all have a personal stake in, seems to hold up better than our interest in institutions that are designed to help "other people." We want the institutions that serve all of us to be good all the time; our interest in institutions specially designed for the poor tends to be sporadic and occasional.

Some persons looking at the present situation are suggesting that what we should do is to have a social insurance program that gives no special advantages to low-income people and that we should treat their special problems entirely in a separate program supported by general revenues. Others say that the only point of the social insurance program is what it can do for the poor and that it should be entirely redesigned in their interests. I would argue that we should continue to have one program of universal usefulness. It seems to me that to the extent feasible we should plan to use our social insurance machinery to prevent poverty among low-income people—including special adaptations as necessary—while keeping the system useful for and acceptable to the community as a whole. This involves compromise in benefit structure. We have here one of the two basic theoretical problems on the benefit side of the program. How far should we go with a weighted benefit formula or with a minimum benefit within the contributory social insurance system? How much of the job of providing a minimum income guarantee to all is compatible with the social insurance method?

The fundamental idea of social insurance—the partial replacement of work income which is lost or reduced as a result of defined causes—is an extremely powerful idea and can go a very long way in preventing poverty and economic insecurity. However, a program which undertook to provide a minimum income guarantee to every last person would at some point have to abandon the method of partial replacement of lost income from work. It is, of course, possible to combine

two programs and to use two different methods in the same administrative structure. Perhaps the first question, though, is how far should we go with the concept of partial replacement of the loss of work income. At what point does a weighted benefit formula or a high minimum benefit endanger the fundamental values of a wage-related contributory system and risk the general support that such a system now has?

I certainly don't have the answer to this question in any very precise way. I will point out, however, that we have a different problem in relation to each of three different groups. I believe contributory social insurance can easily provide for the steady worker who earns low wages over most of his lifetime without significant weakening of the basic idea. In fact, to a very large extent, we are doing this in a satisfactory way now. Under present law, following the 1967 amendments, the worker who has had average earnings equal to the current Federal minimum wage—that is, annual earnings of about $2,800—will with his wife get benefits of just over $2,000. Such benefits are in themselves more than sufficient to keep a couple above the defined poverty level. Even for steady workers who earn below these minimum levels over most of a lifetime, the social insurance approach can easily do an adequate job, although this would require some liberalization of present benefit levels.

It is not so easy to handle the problem, however, for those people now retired or about to retire who had a major part of their earnings in jobs that were not covered under social security until the last 10 or 15 years. These people have low covered wages that result in minimum or near-minimum benefits because their main jobs were not covered under the program soon enough. In the future people who have earnings patterns like theirs will get much higher benefits, but in this first generation of covered workers there are many who have very low benefits for this reason.

Then there remains the long-term problem of the truly marginal worker, the in-and-outer with only a slight connection with the labor force over a large part of his working life. Here the method of social insurance is not entirely applicable, at least for the extreme case. The problem can be mitigated, however, and has been by special provisions in social insurance, such as dropping out years of low earnings or no earnings in figuring benefits. Perhaps some liberalization of the "disability freeze," which protects the benefit level during periods when an individual is unable to work because of disability, would also help in this area, as would computing benefits not up to 65 for men but up to 62 as is done now for women.

Undoubtedly, however, there is a point at which it is unwise to provide fully sufficient benefits through a contributory system for people who have been under the program very little. In the long run I do not believe that this is a problem involving very many people, but to the extent that it exists it could be met either by adding a minimum benefit supported from general revenues and available to all in a given age group, or through improvements in the public assistance program. Incidentally, a good public assistance program, to which people can turn as a reasonably acceptable alternative to social insurance, can help to preserve the values and principles of the contributory program by making it unnecessary for social insurance to try to do the whole

job. A negative income tax, which is one form of a national assistance program, would have the same effect.

A temptation that we are faced with right now is that in this first generation of coverage under social insurance, there are so many of the poor among retired people in the second group—those whose jobs (or, in the case of widows, whose husband's jobs) were not covered until relatively recent years—that one is tempted to push up the minimum under contributory insurance so that it is reasonably adequate in itself. But to go too far in this direction is to risk undermining the principle of the benefit-wage relationship to solve what, in major impact, is a relatively short-run problem. Thus we compromise—correctly, I believe—when realizing that the low-paid worker regularly under the program will get much more than the minimum (even a $40 a week worker will get a monthly benefit of $142 for himself and his wife under the 1967 amendments) we try to arrive at a minimum for the short-term contributor that will do a lot of good now but will not be so high as to endanger for the long run the principle that benefits essentially should grow out of work and contributions.

We have been talking about the extent to which social insurance can be expected to take care of the particularly disadvantaged. The other basic issue on the benefit side is how much social insurance should do for middle-income and higher-paid people. To what extent is the Federal system to be thought of not as guaranteeing a minimum level of living but designed to maintain in retirement a reasonable relationship of income to the past earnings of workers at all levels—middle and higher earnings as well as low-income levels?

There is now widespread acceptance that our arrangements for retirement should be made up of a universal Federal system supplemented by private pensions. There are, however, a number of unresolved policy problems relating to specific aspects of the interrelationship of public and private plans. Perhaps the most fundamental is the extent to which we can count on most workers having the private supplement. There is a growing concern that, after a period of rapid growth, the rate of growth of supplemental private plans is slowing down, despite the fact that a large share of the labor force is not yet covered.

It probably is not true that we can count on most workers in the future having protection under both social security and private pension plans. Just about everybody will have protection under social security or the civil service system or railroad retirement—some 93 percent of the aged do today. But at the present time it is estimated that only about 18 percent of the aged 65 or over receive private pensions (as annuitants or their wives). Even by 1980, it seems probable, private pension supplements will be available to less than a third of all older people over 65.

In addition to concern about the limited coverage of supplemental pensions, the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs pointed out in 1965 that many of the persons "covered" by private plans may not ultimately enjoy the benefits they anticipate. The Committee strongly endorsed the further development of private pensions, as do I, but indicated that, unless vesting of pension rights could be improved,

funding provisions strengthened, better controls established over those exercising fiduciary functions, and certain other improvements implemented, we might find the ultimate results disappointing for millions of workers.

For most of those who will have combined private and public retirement incomes there will very likely be a reasonable relationship of benefits to previous earnings. There is less reason to be optimistic about the situation of the remainder of older citizens. We need to give some careful thought, it seems to me, to ways in which we can assure that post-retirement benefits will be adequate for persons who do not have a private pension supplement—so that the income of such people, in all likelihood the great majority of workers, is reasonably related to *their* previous level of living.

In considering the proper course of development for either social security or the private plans, it is important to take into account what effect a given course of action or inaction in one area will have on the other. Although I think it is clear that we will have both approaches in the future and that both are needed, it is a very important question whether we have obtained the right balance between the two or whether one set of arrangements should be encouraged to grow at the expense of the other. There is, in my opinion, a great need for more analyses comparing the social efficiency of the two approaches. Such analyses need to take account of similarities as well as differences. For example, there has been considerable criticism of the incidence of the social security payroll tax but very little recognition that the incidence of the cost of private plans is undoubtedly very similar. Questions are raised around the issue of supplying more than a minimum income guarantee in a social security system that is compulsory but little recognition is given to the fact that coverage under private pension plans is not really a matter of individual choice and that the private plans are institutional arrangements through which people earn protection as they work, just as under social security—automatically.

Although there are these similarities, comparative analyses would, I believe, make clear the considerable differences between the arrangements in terms of a worker's freedom to move from job to job, the security of payment, the ability of the systems to adjust to rising price and wage levels, the ability to provide universal coverage, and other differences pertinent to social efficiency. I am inclined to think that a proper mix between public and private systems calls for greater recognition that the public plan must in itself be adequate for at least the average worker—which means paying benefits for him related to his level of living and considerably above the poverty line—with private plans encouraged to supplement this broad base.

Revenue Issue

One of the most important issues in connection with long-range financing of the social security program is whether, if benefits are to be raised substantially, we are willing to have the contribution rate—which applies equally to lower-paid and higher-paid workers—raised sufficiently to cover the cost or whether some of the additional financing should come from general revenues.

There is some leeway for improvement in the future without a Government contribution and without increasing the contribution rate. First of all, the base to which the rate is applied can be signficantly increased, an approach which would have the additional effect of making the program more effective for the somewhat above-average earner. But leaving this point aside, I don't believe there is general realization of the extent to which the *present* financing would allow for increased benefits as wage levels rise. Because of the weighted benefit formula, if the maximum earnings base is increased somewhat from time to time (it does not have to be increased proportionately to increases in earnings levels for this purpose), contribution rates in present law will produce sufficient income to considerably more than keep benefits adjusted to future increases in prices. Of course, it may well be that in America we will want to increase benefits substantially more than can be financed by a higher earnings base and out of rising earnings. If we do, it is at this point that the issue of a Government contribution will be seriously considered.

A Government contribution comes up in connection with both of the matters already discussed—that is, making the system more adequate for the poor and improving the system for average and above-average earners. If benefits at the lower wage levels are to be substantially higher than they are, the most disadvantaged need more of a subsidy. And those at average and above-average earnings levels do not want too much of the subsidy to come from payroll contributions that would otherwise be available for benefits of one kind or another to them.

Other Unresolved Problems

The broad policy issues discussed thus far are certain candidates for the agenda of the next Advisory Council on Social Security, which must be appointed early in 1969. It will ponder as well some other as yet unresolved problems.

One of these is early retirement. There is as yet no adequate understanding of the extent to which we are developing a problem of low benefits under social security arising out of the provisions for actuarial reduction of benefits when people retire before age 65. More than half of all people now retiring do so before age 65 and therefore get reduced benefits. The amounts are very substantially below what they would get if they waited until they could receive their benefits in full. The evidence indicates that generally they claim benefits early because they cannot any longer secure employment or are in ill health and unable to continue at their regular occupation, and they thus have little real choice.

The average benefit for men who take the actuarial reduction is $15 to $20 a month lower than the average benefit being awarded to those retiring at age 65 or above. In the long run, if allowed to continue, such a situation might actually reverse the long-range trend of reduction in the old-age assistance rolls. On the average, the longer a person is in retirement, the more likely he is to have used up whatever resources he took with him into retirement, and the more he becomes wholly dependent on his social security income. Thus, those people taking early benefits may later on have to apply in increasing numbers for assistance. Since 1950, largely because of social security,

the proportion of the aged receiving assistance has been more than cut in half, dropping from 22 percent to about 10 percent today. It would be tragic to have this trend reversed.

The low benefits paid to those retiring early is a serious and developing problem. It may require some modification of the actuarial reduction provisions, or perhaps some liberalization in the disability program as it applies to older workers would be helpful.

Another issue involving the disability program is whether it should take on somewhat shorter-term illness, say by reduction in the waiting period for disability benefits from 6 to 3 months and dropping the requirement that the disability must be expected to last for at least 12 months.

Health insurance is, of course, very new. We have recommended the inclusion of the disabled social security beneficiary. Should other social security beneficiaries—widows and orphans—be included later on? Is extension of the program to cover prescription drugs feasible and desirable? What can be done about incentives for efficiency in the delivery of quality service by institutions? What can be done about helping to control the increasing cost of medical and hospital care?

It seems likely that the basic protections provided by the social security system will continue to be adjusted to economic changes in the future as they have been in the past. We have not as yet, however, resolved the important question of whether or not the adjustment process is to be entirely on an *ad hoc* basis as in the past, or whether the adjustments should, in part, be made automatic by relating benefits not to a career average but to, say, a high 5 or 10 years, or perhaps even by introducing automatic increases in benefits after people come on the rolls.

These are all important issues and there are many others of, perhaps, lesser importance.

Conclusion

As over the next several years we consider the next steps to be taken to improve the economic security of the American people, I believe that the method of social insurance will be called upon to do an even bigger job than it is doing today. I believe this is true because it is greatly advantageous to build on a going system of universal application, based upon principles that have wide acceptance and have proven enduring. At the same time, I believe we will have to ask ourselves what is appropriate for social insurance and what is not. The idea of insuring against the loss of work income has wide application in any attempt to improve our economic security arrangements. But the institution of social insurance should not be expected to cure the problem of income deficiency singlehanded, nor should its failure to do everything make us value less the great contribution to security that this institution can appropriately make.

In my judgment, solutions to the many-sided problem of income deficiency will be found not in a single program but in a variety of programs—both public and private. In this field, the simple, single answer—while intellectually appealing perhaps—will not produce satisfactory results.

ECONOMIC SECURITY IN OUR FREE SOCIETY

BY ANDREW A. MELGARD*

The search for economic security is universal and continuous. We are witnessing in this 20th century an intensification of that great human drive that all individuals and families have to achieve financial security. To the surprise of many, affluence does not decrease economic security ambitions or needs. It increases them. As standards of living rise, the desire and need to protect what has been achieved becomes greater.

In our free society, we have developed a mixed approach to providing economic security throughout the lifetime of an individual. We have various institutions and mechanisms which help to provide savings, homeownership, capital accumulation, insurance and income maintenance. Individuals, employers, unions, financial institutions, and all levels of government share in the responsibility for the success of this great, interdependent system.

This complex system we have developed for meeting economic security needs is a part of our free enterprise system. Just as the desire for economic goods and services is unlimited, so is the search to satisfy economic security needs and demands. Individual savings, investment and insurance; social security, tax policy and public assistance; employer-provided fringe and employee benefits; intrafamily and charitable aid all contribute to meeting these needs. The component parts of our economic security system are not perfect. They are simply the most successful institutions yet devised by human minds to provide economic security. The end result is that our free society's high standards of living and high levels of economic security are the envy of the rest of the world.

Our old age income assurance systems involve an entire spectrum of issues. It is difficult to isolate these issues from the entire fabric of our complex economic security system that protects individuals and families throughout their lifetime. When an individual retires, he lives on the sum total of everything he has accumulated during a lifetime. His economic comfort in retirement reflects, to a large degree, both the economic security steps taken throughout his life as well as the manner in which the entire economic system he worked in has helped him to have an opportunity to achieve financial security in old age.

Old age income assurance issues are, therefore, but one part or aspect of a much larger issue that must be answered in the years ahead. *How will responsibility for the economic security of the individual be shared by government, the employer and the individual himself?* This is a major question that will occupy us during the closing one-third of the 20th century. It is obvious that, during the next decade,

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there will be a great dialog on economic security issues. The questions raised will have serious social, political and economic implications.

The decisions made as a result of this national dialog will help shape the kind of government, economy, family life, and citizenry we will have by the close of this century. These decisions will affect the rate of our new capital formation and the degree to which these funds can help us meet national goals such as price stability, full employment and economic growth. The extent of freedom for the collective bargaining process to operate in our economy will be decidedly affected by any push for further Federal control of the private pension and related employee benefits areas. Of key importance will be the extent to which management retains discretion to provide flexible, tailormade employee benefits and pensions to help meet the overall economic needs and demands of various groups of employees. Of paramount importance will be the amount of freedom the individual retains in our society to manage and control the economic value of his own life.

The immediate need would appear to be for a broader and more comprehensive understanding of our complex economic security system. Elected representatives, Federal officials, academicians, employers and union leaders will all benefit from a more precise knowledge of how our public, private and individual efforts to achieve economic security are working together today and what can be expected from them in the near and long-range future. The need for further research and study will be evident. Equally clear will be the dangers of competition from the Federal Government to take over more and more control of employer, union and individual efforts. What will be obvious is the necessity for cooperation among public and private programs so that the individual assurance of economic security may be satisfied without any diminishment of individual economic freedom of choice and opportunity.

For all these reasons, the Joint Economic Committee's symposium on issues and alternatives in providing old age income assurance is most timely. The compendium of papers to be published by the committee will provide a foundation for a true national dialog on old age income and related economic security issues. The Chamber of Commerce of the United States is pleased to present some of its views on some of these issues in these remarks.

The Growth of Economic Security for the Individual

The average 20th-century American survives on income—earned income. The economic value of the individual's life—his ability to earn income and save—is subject to certain hazards. The major ones are death, disability, old age, and unemployment.

Until the 1930's the responsibility for meeting these hazards was largely left to the individual. With the economic breakdown that came with the Great Depression, government and the business community assumed more responsibility in these areas through collective approaches. Social security is a mandatory collective approach to provide a "floor-of-protection" to help the individual find economic security. Fringe benefits, of which pensions are a part, are the collective approach used by an employer for all his employees.

Today, in his quest for economic security, the average American enjoys three layers of protection. The bottom layer is provided by social security. The middle layer is the fringe benefits provided by his employer. The top layer is what he does for himself—homeownership, insurance, annuities, savings accounts in banks and building and loan associations, mutual funds, common stocks, corporate and government bonds, property or business ownership, and other forms of savings and investment.

Our allocation of funds to security mechanisms are estimated to have increased more than tenfold since 1940. This is massive growth and positive response to the economic security needs of our citizenry. It has been estimated, for example, that aggregate social security taxes for calendar year 1967 will exceed $25 billion. This would be a 50-percent increase over the 1964 tax collections of about $17 billion. The final figures for this year could be increased depending on the progress of H.R. 12080 in the Congress.

Fringe benefits now cost American businessmen a staggering $75 billion plus each year—four times as much as the dividends paid to stockholders. Furthermore, the most recent chamber survey shows that fringe benefits costs are shooting up almost twice as fast as wage rates. In the area of pensions alone, employers have put almost $100 billion in assets in trust to help guarantee income and financial independence to employees in retirement. Currently, about 3 million persons are receiving monthly checks that amount to $3 billion a year from these private retirement plans. These plans continue to grow each year in the number of employees covered, the benefits offered and the assets placed in trust.

Increases in personal savings and investment match the growth in social security and employee benefits. Department of Commerce figures show personal savings for the year 1966 reached a new all-time high of $27 billion. In 1966, approximately 63 percent of the Nation's homes were owner occupied, well up from 43 percent in 1940. Over-the-counter savings in our banks, savings associations, and credit unions totaled $325 billion by the end of last year. Premium receipts of life insurance companies totaled $26.5 billion for 1966 and we now have over a trillion dollars of life insurance in force. Meanwhile, each year sees more Americans buying and holding common stock and other securities.

The remarkable part of this phenomenal advance during the last 30 years in the provision for economic security is the newness of it all. Social security is only 30 years old and the system is not really expected to fully mature for many years. Private pensions were in existence long before social security but the great growth has occurred mainly during the last 25 years. Related employee benefits began to soar in volume only beginning about 1950. Furthermore, the continuing ingenuity of American financial enterprise can be seen in the new approaches to savings and investment as evidenced by such diverse developments as the monthly investment plan of the stock exchange, the variable annuities devised by life insurers and the application of the mutual fund concept to investment property through the organization of real estate investment trusts.

There has been some concern whether employer-provided private pensions cause covered employees to save less money. One prevailing notion was that if a person was covered by a pension plan it would

weaken his motivation to save and induce him to spend more liberally. But in a recent study made by George Katona of the University of Michigan's Institute for Social Research, it was concluded that coverage by private pension plans actually stimulates individual savings. So the notion that Americans will tend to reduce their personal savings by the amount they and their employers put in pension plans has been contradicted.

A somewhat similar research project was conducted by Philip Cagan, and the results published by the National Bureau of Economic Research. Mr. Cagan's analysis indicated that when a household comes under a pension plan there was no offsetting reduction in other forms of savings.

Private pensions, therefore, do not reduce other individual or family savings. In fact, they stimulate greater savings effort.

The Obvious Consensus

The search for a consensus on the way to achieve economic security and old age income assurance should be a short one. There is an obvious consensus. Our citizenry likes what it now has.

First, Americans expect social security to provide a floor-of-protection against want. They look to Congress to periodically review OASDI benefit levels to maintain this objective. There is an obvious concern about the effect of increased social security taxes on employers, employees and the self-employed. We see no support for changing social security into a poverty program, or making it a complete retirement system for all levels of income, or for using general revenues to finance social security benefit increases.

Second, American employees enjoy pensions and fringe benefits. They want larger pensions and more fringe benefits. A day-to-day review of wage negotiations shows the obvious interest of unions and employees in improving fringe benefit programs. We see no evidence for any demand for Federal controls or restrictions that would diminish the flexibility of these programs or limit the free collective bargaining process.

The National Chamber follows a positive, clear-cut approach on private pension plans. Chamber policy calls for maximum encouragement for the continued growth and expansion of private pension plans. At the same time, every effort is made to ease or prevent any needless governmental restrictions which will hamper the growth of pensions. In short, the business community wants to see private pension plans improved and their benefits spread to more employers and employees. Employers and employees should remain free to work out pension plan arrangements and other fringe benefits best suited to their own needs and requirements.

It must be more clearly understood that an employer has a given sum of money to devote to programs designed to ease the economic hazards facing all his employees—death, disability, hospitalization, unemployment, and retirement. The amount of these available funds will vary from company to company and from industry to industry. In distributing these funds, the employer must consider the economic needs and demands of all his employees, including young, middle-aged and older workers, male and female employees. Often young single

men and women prefer more take-home pay to fringe benefits. Young married men with children are more interested in life and hospitalization insurance than far-off retirement pay. Some workers want longer vacations. Older workers are interested in pension and other retirement benefits. The employer, either unilaterally or through free collective bargaining, must reconcile these conflicting demands and work out the fringe benefit package, in correlation with public benefits, such as social security and unemployment compensation. If the Federal Government moves into the picture, both employer and employee discretion and choice will be limited. The Government will be saying unless you can set up a pension plan that meets all of these requirements, don't set up any at all. The Government, in effect, will be deciding what the employee wants and what the employer can afford.

All indications point to the continued growth of private pensions and related fringe benefits—if they are granted enough flexibility and room to grow.

One of the major concerns of the business community is for the extension of pensions to those employees not now covered. The concern with further Federal controls over pensions is that, because of increased costs and other problems, the growth of private pension plans will be slowed. Federal restrictions will only guarantee that a large number of employees, not now covered, will not even have an opportunity to come under a pension plan.

It is generally considered that the two largest areas where pension growth is needed are among the self-employed and smaller corporations.

On April 18, 1966, in a committee print entitled "Data on Self-Employed Retirement Deduction for Taxable Year 1964," the Committee on Ways and Means of the House of Representatives published a Treasury Department report on H.R. 10 plans. Members of Congress were shocked to learn that less than 40,000 persons had availed themselves of the benefits provided by the Self-Employed Tax Retirement Act. It was well known that there were over 6 million self-employed persons who employed over 9 million individuals. Some authorities have estimated that close to 20 million are self-employed or work for the self-employed.

Although the Treasury Department strongly objected to changes in the law, it was obvious to the Members of Congress that restrictive tax provisions were destroying the opportunity for millions of persons in the self-employment segment of our economy to build effective retirement income. By an overwhelming vote of 291 to zero, the House of Representatives moved to ease the inequitable and restrictive tax provisions contained in the Self-Employed Tax Retirement Act. Subsequently, the Senate voted favorably and the easing of these tax provisions has been provided for in Public Law 89–809 of the 89th Congress. The removal of these restrictive tax provisions will not be effective until the end of 1967. Already, additional widespread interest in creating H.R. 10 plans has been in evidence.

Among smaller corporate employers, the adoption of a revenue procedure that would make it easier and less time consuming for smaller employers to start pension plans would do much to spread the benefits of private pensions to more employers and their employees. We understand that the Internal Revenue Service has been studying the possi-

bility of adopting a procedure that would permit the filing of master and prototype pension plans for smaller corporate employers. Such a procedure, if adopted, would greatly encourage those employers who do not have pension plans to establish one.

Third, in the area of individual savings, it is obvious that total savings and investments by individuals are increasing. The two major complaints of Americans in this area are about inflation and increased taxes. Despite substantial wage increases, the inflation we suffered in 1966 and which continues in 1967 seriously hurts the value of the saved dollar and fixed retirement incomes. When the effect of inflation is coupled with increased taxes at various levels of government, the effect on the average American is to make him feel that he is standing still or losing ground.

The Chamber thinks that all individuals should be encouraged during their working lives to build private retirement income out of earnings either on an individual or group basis. Restrictive tax provisions impeding this should be modified in an equitable manner. Individuals should be permitted to exercise maximum freedom of choice in the selection of savings and investment media for personal or group retirement planning.

In summary, although disturbed by inflation and increased taxes, there seems to be an obvious acceptance of social security as a floor of protection, plus a great desire for freedom to secure fringe and pension benefits from employers and to save and invest on a personal or family basis to achieve economic security goals. Although the growth and refinement of our economic security institutions are expected in the future, we observe no demand for radical departure from what we have thus far achieved.

Problem Areas

Despite the tremendous gains that have been made and are continuing in all areas of individual and family economic security, serious problems remain. The two groups of citizens deserving and receiving a priority of attention are the poor and the elderly in our Nation. We have always had, of course, a special line of defense for those individuals who either cannot or do not readily find it possible to secure or maintain sufficient income. Our welfare programs have assisted these citizens to obtain the basic, or bare, essentials. In addition, our welfare aid is abetted by intrafamily income sharing and help from private charity.

To identify and provide solutions in the poverty area, the Chamber of Commerce of the United States created a special task force of businessmen. The Task Force on Economic Growth and Opportunity is made up of more than 100 chief executives of major American corporations who have been asked by the Chamber to make serious independent studies of important domestic problems. It has been examining poverty in America. The Task Force is an independent group making independent studies. It is not bound by present or past policies of the Chamber. Conversely, the National Chamber is in no way required to endorse Task Force recommendations. In pursuing its poverty studies, the Task Force has made maximum use of expert advice. Three reports on poverty have so far been published. The first,

entitled *The Concept of Poverty*, attempts to define more clearly what we mean by describing someone as "poor," to assess the dimensions of the poverty problem in the United States, and to develop a general approach to the problem as identified.

The second report, entitled *Poverty: The Sick, Disabled, and Aged*, analyzes specifically the medical and social needs of those excluded from the labor force by sickness, disability, or old age. It puts forward 28 recommendations aimed at mitigating the economic impact of these circumstances and at improving the quality of life for those inescapably afflicted.

The third published report is entitled *The Disadvantaged Poor: Education and Employment*. It analyzes the difficulties faced by those whose contribution to society is minimized through racial discrimination, insufficient education, inadequate employment opportunities, or some combination of the three. It makes 28 recommendations aimed at upgrading the contributions and earnings of the disadvantaged.

Reports on individual and family security and on rural and regional poverty are now in preparation.

These reports have been distributed to Members of the Congress and officials of the executive branch of the Federal Government, to university social science departments and libraries, and to interested individuals and organizations around the Nation. More than 20,000 copies of the first three reports have been distributed, and they are still in strong demand.

Critical response has been excellent. The reports have been praised by responsible public and private individuals of all political persuasions and have been favorably reviewed in leading publications.

This Task Force has acted in the conviction that the business community can play an important role in combating poverty. It has emphasized that poverty is among our most important domestic problems. It has determined that, by and large, America's poverty problem is not a *subsistence* problem, but rather a problem of *relative* poverty. The Task Force does not find a need of radical economic change.

Expert after expert, when consulted by the Task Force, has emphasized that income and place in the social and economic scheme can best be restored by providing the employable poor with training and job opportunities. These have the effect of bringing the poor into the mainstream of the economy, rather than merely paying them to remain outside. At the same time, authoritative opinion has suggested that some of the poor—the aged and totally disabled, for example, cannot take advantage of these opportunities, no matter how attractively presented, and must depend on a humane social system for even a minimum standard of living. The Task Force has made far-reaching proposals designed to offer enhanced earning power to those whose circumstances have prevented the full use of innate talent.

The interest of the Task Force in alleviating poverty is founded in hard economic realities, as well as in its concern for social justice. An enterprise economy operates most efficiently and productively when its resources, human and material, are free to flow to their most productive uses. Waste in human resources is at least as costly as imprudent use of physical resources. Poverty concerns the Task Force because of its implications in lost output, as well as its cost in human misery. A growing, dynamic economy benefits all of us. Making optimum use of

our human and material endowment enables us to better afford to support the necessarily nonproductive. The Task Force finds that abundance with dignity can best be achieved by enabling more of our citizens to earn a fair reward for productive work.

To stimulate further thinking on possible ways to combat poverty, the Chamber held its National Symposium on Guaranteed Income in December 1966. This is another example of the business community's recognition and acceptance of its responsibility for developing and applying sound workable solutions to poverty and its willingness to explore all new proposals. Although the concepts of guaranteed income and negative income tax programs are novel, the suggested advantages and disadvantages of such ideas were explored to see if even what are considered radical departures have anything to offer in the poverty fight.

Through the achievements of our private enterprise system, the businessman has always been engaged in a crusade for affluence. Perhaps some of the negative aspects of the war on poverty can be cured through a broader recognition of the success the business community may achieve in helping to identify and solve poverty problems.

The second group of Americans who have required a high priority of attention are the elderly. There is an overlapping of the problems of the poor and the elderly poor. Young and middle-aged poor people end up as the elderly poor and, of course, poverty among the elderly is as serious a problem as among any other age group.

Old age income assurance and retirement income have become much more important issues during the last 20 years. There are many reasons for this. First of all, through the modern miracles of science and medicine, our average age span has increased phenomenally. Second, we now have 19 million people age 65 or over, a sizeable percentage of our total population. Third, as we changed from a rural, agricultural economy to an urban, industrial and service economy, each individual American's dependence on steady income to provide for the necessities of life became greater. Finally, in addition to social and economic factors, there has been a political discovery of the aged. The needs and wants of 19 million elderly voters is of obvious concern to all our elected representatives.

Certainly we have a clearer understanding today of the problems of the elderly than we did just a few short years ago. Yet, it is important to distinguish between the retirement income problems of our present retired population and the problems that will face those still working.

Disregarding the very elderly, our present retired citizens are between the ages of 65 and 90. This means most of them retired between about 1942 and 1966. It is important to keep four factors in mind about these particular citizens: the depression, the post war inflation, the growth of social security, and the growth of private pensions. Their savings and retirement income were seriously hurt by the depression and inflation; they got in on only the beginnings of social security and private pension plans. Many a man in this group will see a grandson or granddaughter graduate from high school or college this year, immediately begin to work and receive a starting income larger than the grandfather ever earned in his lifetime.

The new affluent "generations" have higher incomes, higher social security benefits, more private pensions, more savings and investments. It should be clear that solutions for retirement problems for the present affluent working generations should not be based on the problems that beset our present retired generation. For example, two relatively new problems are early retirement because of technological advances, including automation, and post-retirement job opportunities for pensioners who wish to continue working beyond what are considered normal retirement ages. We will not be able to use the thinking of the 30's and depression solutions to help retirees to solve the problems that will be faced by future retirees of our more "affluent" society.

Private Pension Plan Issues

PRESIDENT'S COMMITTEE ON CORPORATE PENSION FUNDS AND OTHER PRIVATE RETIREMENT AND WELFARE PROGRAMS

In March 1962, following his Economic Report to the Congress, President Kennedy appointed a cabinet level committee to review legislation and administrative practice relating to private retirement and welfare programs. The President wanted a report by November 15, 1962, to use in drawing up the administration's legislative program for the 1963 session of Congress.

A provisional report of the committee was studied by the President's Advisory Committee on Labor-Management Policy. This committee found that: "Wide latitude should be permitted in the establishment of private pension plans consistent with the concepts of the free economy and the divergent needs and circumstances of various firms and industries."

Individual members of the committee made specific, critical comments about the recommendations in the report. For example, Henry Ford II, Chairman of the Ford Motor Co., said, "I believe it follows that the widest possible scope should be given to private decision-making in the design of private pension plans, consistent with the public interest in preventing abuses. The present Treasury regulations covering qualified pension plans already afford protection against abuses, and to my mind the committee has not been presented with convincing evidence of the need to change them in the respects recommended in the report."

Arthur F. Burns, President of the National Bureau of Economic Research, Inc., said, "Although I have sympathy with the spirit of the recommendations in regard to funding, I feel it inadvisable to endorse any specific proposal until facts are fully developed on the cost implications for relatively small and financially weak firms."

W. Anthony Boyle, President of the United Mine Workers of America, said, "The proposed report to the President is based on the erroneous concept that governmental specification of standards in private pension plans can be mandated by public law to a similar extent that such standards are fixed by law in public pension plans."

Despite such criticism, the final report of the President's Committee on Corporate Pension Funds was released in January 1965. It contained a large number of highly controversial recommendations for possible changes in the Federal laws and regulations affecting private

pension plans. Essentially, the report contained a strong vote of confidence in the manner in which private pension plans had been conceived, established and administered without government involvement. However, the report caused widespread concern because it appeared that the Federal Government was preparing to use its tax powers to further regulate private pension plans. It was feared that the operation and growth of the private pension plans system would be harmed if the recommendations were enacted into legislation.

Although the President's memorandum called for a study of private welfare (health and insurance) plans and programs, no such study was, or is, being made. In addition, President Kennedy had suggested that since the Welfare and Pension Plans Disclosure Act had been amended in 1962 to provide enforcement procedures and penalties for embezzlement, these subjects could be excluded from the committee's consideration. Yet, the first administration bill arising out of this report's recommendations were the proposals made in 1967 to amend the Disclosure Act. The memorandum also asked for a study of how retirement and welfare funds affect efficient manpower utilization and mobility. Although the Report went into the problem of mobility. there is little evidence that pensions rank as a significant factor in this area. Reluctance to sacrifice seniority is the principal reason for workers' immobility. A study in the March 1967 edition of the *Social Security Bulletin* states that any evidence that pension rights inhibit mobility "is very weak." This fact has an important bearing on how much need there is for early vesting or portability of pensions.

The report concluded by calling for comprehensive long-range studies and research.

THE INTERAGENCY STAFF COMMITTEE

In 1966, the interagency staff committee was reactivated. This committee is comprised of representatives from five Federal Departments and four Federal agencies: Commerce, HEW, Justice, Labor, Treasury, Bureau of the Budget, Council of Economic Advisers, Federal Reserve System, and Securities and Exchange Commission. The staff group is still involved in developing various study papers on the general question of public policy in private pension plans. A number of issues are still under active consideration, and this group is not making available to the public any additional materials at this time. The membership of this group shows how fragmented the bureaucratic approach to an issue like private pension plans can be.

The only clues as to the present thinking of this committee came in a talk by Stanley S. Surrey, Assistant Secretary of the Treasury for Tax Policy before the American Pension Conference last May. Although Mr. Surrey made it clear that he was not speaking for the administration or other Government officials, he suggested the need for 10-year vesting, 25-year funding and some type of Federal reinsurance for all pension funds. He referred to these proposals as initial "building blocks" for "pension reform." A brief examination of these proposals may be helpful.

Vesting.—Mr. Surrey proposed 10-year vesting. In some cases, service before age 25 could be disregarded. New plans would not be required to meet any vesting standard for employees leaving during the first

5 years. Transitional features would stretch out the full impact for 12–13 years. Other optional features were suggested by Mr. Surrey.

The majority of private pension plans provide for vesting; the trend is to more and earlier vesting; it is considered desirable. Mr. Surrey would make it mandatory. There was no discussion of the cost of mandatory vesting. There would be no latitude for collective bargaining (other desirable features in pensions might be preferred by unions or employees before 10-year vesting is reached). No evidence was offered that the absence of 10-year vesting is an important factor affecting labor mobility.

There was no discussion of contributory plans. For example, it has been estimated that about 90 percent of Federal employees who leave Federal service withdraw their contributions to the civil service retirement system, preferring not to vest. Would employees be locked in on 10-year vesting? There was no discussion of the suggested Federal portability fund which would receive the assets of the vested pensions of employees who left their employer. Full consideration was not given to the fact that because of cost factors earlier vesting will help departing employees at the expense of those who remain to retire. Finally, there is the question of whether the cost of 10-year mandatory vesting would result in fewer private pensions for our American citizenry.

Funding.—Under the Surrey proposal, plans would be given 25 years to reach a goal of "assets equal to vested liabilities." Each plan would have a funding target to meet each year in terms of a percentage of assets at market to vested liabilities. This target would be increased at an annual rate equal to 47 percent of vested liabilities. Adjustments in the schedule would be permitted to account for amendments to the plan which substantially alter liabilities. To ease the transition for existing plans a more gradual schedule would be applied for the first few years after the legislation is enacted. A report would have to be made to the Government every 3 years. Penalties would be applied to plans that were unable to meet the funding requirements. Mr. Surrey mentioned the study of funding being made by the Pension Research Council of the University of Pennsylvania. This study will be completed toward the end of this year. The Department of Health, Education, and Welfare has contributed funds to this major research project. It is difficult to understand why the Federal Government should get locked in on funding legislation before evidence is available upon which a sound judgment could be based.

The social security trust funds have assets slightly over $20 billion for liabilities far exceeding those of private pension plans which have assets of close to $100 billion. The civil service retirement fund for Federal employees has unfunded liabilities of $50 billion. When the Pension Research Council's study is released, it will be interesting to compare the funding performance of private plans with the performance of Federal and other governmental plans.

No one disagrees with the importance of proper funding of pension plans. Present Treasury requirements, in most cases, are that minimum funding must be equal to current service costs plus interest on past service costs. In the absence of evidence of large-scale underfunding, why should Federal requirements be increased? Furthermore, it is difficult to see how the plan proposed would not have to be based on specific actuarial and cost assumptions, yet it is claimed the Govern-

ment will not get involved in this area. Such added requirements could lead to pension fund investment control. Finally, there has been no full discussion of what effect such requirements would have on the establishment of new plans or the liberalization of existing plans. Is this not an unnecessary burden that could well deprive many American workers of the opportunity for more and larger pensions?

Reinsurance.—Mr. Surrey proposed that a common fund should be established to meet any particular plan's unfunded liabilities in the event of its termination while moving toward full funding of vested liabilities. Each plan would make contributions based on the amount of its unfunded vested liabilities. If a plan were terminated for business reasons, amounts from the common fund would be available to make up the difference between its funding target and vested liabilities not covered by plan assets. The termination protection would not apply to the extent an employer had not met his prescribed funding target, either because of a deficiency in contributions or an abnormal drop in the value of the assets in the fund.

The most recent study of termination of pension plans covers the period 1955–65. This study was supposed to prove the need for reinsurance. Conducted by the Bureau of Labor Statistics and published in the June 1967 edition of the *Monthly Labor Review*, it shows that about 20,000 employees a year *can* be affected by terminations—about one-tenth of 1 percent of total pension plan coverage. These figures include business mergers and sales where employees are transferred to other pension plans and suffer no loss. Also included are business dissolutions where the pension plan is fully or almost fully funded and there is no loss, or only a nominal one, to plan participants of beneficiaries. The study concludes as follows:

"Reasonably accurate estimates of the magnitude of benefit losses cannot be obtained from any Government reporting system now in operation. Unless such reporting systems are changed, only a special survey program can produce more reliable data."

Therefore, we still do not appear to have the basic facts required to support sound judgment on the need for Federal reinsurance and related proposals.

INTERNAL REVENUE SERVICE ANNOUNCEMENT 66–58

To be designated a qualified plan under the 1954 Internal Revenue Code, the benefit structure of a retirement program cannot discriminate in favor of executives or highly paid employees. A formula is used to determine whether any such prohibited discrimination exists. Under this formula, an employer is permitted to take into account benefits provided by the social security system. The Cabinet Committee Report has recommended changes in this area.

In announcement 66–58, dated September 19, 1966, the Internal Revenue Service requested background information from interested persons for developing a new integration formula. The announcement contained a new suggested IRS formula. If such a formula were adopted, existing pension plans would have to be changed although they have been approved for tax qualification as being non-discriminatory. In addition, new plans, not yet approved, would have to meet the new formula.

A new Treasury regulation in this area would affect virtually every integrated pension or profit-sharing plan in the United States. Such a new requirement could mean either an increase in pension costs by as much as 40 percent or more, in some cases, or benefit decreases of 25 percent or more for some employees.

Over 3,000 employers and pension experts responded to this request. In January 1967, the Treasury Department temporarily shelved its newly proposed formula and appointed an advisory panel to furnish advice to the Department on this problem. This panel will restudy the entire matter, evaluate the suggestions made and take into account action on pending social security legislation before making final recommendations.

(After 30 years, it is interesting to note that our Federal civilian employees are still not covered by social security nor do they pay social security taxes. Changes in social security taxes and benefits and promlems of integrating social security with another pension system do not personally affect Federal Government employees. The departmental officials who help develop Administration policy have not ordinarly had the month-to-month pocketbook discipline of seeing social security taxes withheld from their take-home pay. They are virtually in the position of saying "Do as we suggest, not as we do." Although various proposals have been made over the years to bring Federal civilian employees under the social security system, they have all failed.)

THE FEDERAL ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFIT PLANS

The Federal Advisory Council on Employee Welfare and Pension Benefit Plans was created by Congress when it passed the Federal Welfare and Pension Plans Disclosure Act. Congress specified that the Council should include representatives of the general public, labor, management, the insurance field, the corporate trust field, and other interested groups. The duty of the Council is to advise the Secretary of Labor on how he should carry out his functions under the Disclosure Act. To retain control, Congress required that the Council's recommendations be transmitted to the Senate and House each year when the Secretary of Labor reports on his administration of the Disclosure Act.

The Council was asked last year to consider further changes in the Disclosure Act. In December 1966, the Council unanimously agreed "that Congress acted wisely in placing primary reliance in the original 1959 act and in the 1962 amendments on insuring integrity of plan performance through meaningful public disclosure of plan operations. The Council further believes that the will and intent of Congress as expressed specifically in the 1962 amendments to the act with respect to prohibitions against giving the Secretary of Labor any added powers—'to regulate or interfere in the management of any employee welfare or pension benefit plan'—should be preserved."

The council wants to see all welfare and pension plans administered in accordance with the highest standards of fiduciary conduct. The Council does not think, however, there should be a Federal statute for pension trustees unless it can be shown that "existing State law is inadequate and cannot be reasonably expected in the near future to provide assurance of satisfactory fiduciary performance."

Based on the recommendations of the council, it is clear that all the members are opposed to giving the Secretary of Labor additional controls over private pension plans although they do wish to see any proven deficiencies in the Disclosure Act corrected. The council report reflected a growing concern about burdensome and unnecessary Federal regulation and interference in all employee benefit plans. In effect, the unanimous report of this council was saying to the Federal Government, "slow-down or stop" in your takeover of private pension plans.

CONGRESSIONAL ACTION

So far, over 30 pension bills have been introduced into the 90th Congress. In addition to possible hearings on the administration's bill in the disclosure field, hearings may be held on various aspects of private pensions by the Fiscal Policy Subcommittee of the Joint Economic Committee and by various subcommittees of the Senate Special Committee on Aging.

Already, there have been at least six major hearings on pension issues held among the Subcommittee on Employment and Retirement Incomes of the Special Committee on Aging, the Senate Permanent Subcommittee on Investigations, the Subcommittee on Fiscal Policy of the Joint Economic Committee, the Senate Finance Committee and the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare.

One of the most significant hearings was held by the Subcommittee on Employment and Retirement Incomes of the Special Committee on Aging. In March 1965, Senator Randolph's subcommittee explored the possibilities of extending private pension plan coverage. Chamber testimony emphasized the importance of Government encouragement for the establishment of new plans and freedom from hampering Federal restrictions. Finding No. 4 of this committee, which was contained in the report issued in June 1965, stated: "The Federal Government is not doing all it can do and should do to encourage and stimulate the extension of private pension coverage." Following that finding, the subcommittee made a series of helpful recommendations. The specific recommendations on the Self-Employed Individual Tax Retirement Act of 1962 (H.R. 10 plans) were particularly significant in advancing the objective of this subcommittee: to provide more and better private pensions and more adequate income for the elderly.

Recommendations No. 5 and No. 6 of this subcommittee were as follows:

Recommendation No. 5.—The subcommittee makes no recommendation on the adoption or rejection of the recommendations in the report of the President's Committee, since most, if not all, those recommendations are outside the scope of this inquiry. However, it does recommend that each of those recommendations be considered in the light of its possible effect upon extension of private pension coverage and that recommendations expected to have an adverse effect upon such extension be implemented only if there is reasonable expectation that the resulting improvements to the Nation's private pension system substantially outweigh their adverse effect upon such extension.

Recommendation No. 6.—This subcommittee recommends that the President direct his Committee on Corporate Pension Funds and Other

Private Retirement and Welfare Programs to conduct a study on extending private pension coverage and to report on this subject with recommendations for sound, effective Federal actions to bring such coverage to more Americans.

THE REAL ISSUE

In the final analysis, of course, the specific details of proposed Government regulations and standards for private pensions and their mechanical feasibility are not the real issues. The real issue is the extent to which the private plan system will be forced into a Government-dictated mold—and the extent that such rigidity may hamper the growth of established plans and the creation of new plans. The federalization of private pensions is a negative approach.

A positive approach lies in the search for methods for spreading the benefits of private pensions to employers and employees who do not now have them, and to give both employers and employees wide flexibility in tailoring plans to their individual financial abilities and desires.

NATIONAL GOALS AND PRIORITIES AND THE ECONOMICS OF CHANGE

Any consideration of the future of our programs to provide old age income assurance must give full recognition to the manner in which these programs relate to our national goals of economic growth, full employment, and price stability. Any further Federal efforts in the providing of old age income must assign a priority to these items as they relate to other national goals such as urban development, education, international aid, manpower retraining, natural resources and many other important programs. (It is perhaps regrettable that our social accounting system for evaluating the cost of social ills is not more advanced. Certainly it would be most helpful to compare the cost of our various welfare programs with an evaluation of their output.) Another difficult problem is to relate any changes proposed in old age income assurance programs to the economics of change which will effect us throughout the remainder of this century.

Recent Chamber studies indicate that we can look forward to significant changes affecting our economy in the following general areas:

By 1985, we may have a population of 266 million with young people making up the greatest part of this population growth.

Urban centers, already so dominant, will play a much larger role in America's future. As we become a Nation of multi-cities, our rural population will decline.

America's labor force will change drastically in the years ahead and will be composed of more younger workers and more women workers. Spending for new plant and equipment by American business totaled $378 billion during the past 10 years, while the labor force was growing by 9 million. With the labor force growing at a 70 percent to 80 percent higher rate during the next two decades, and with considerably higher average investment per job, the substantial rise in capital investment required is evident. New investment averaging about $30,000 is required for every new job opening in the national economy.

Our greatest asset—better educated Americans—will increase substantially. The demand for educated workers will forge ahead while occupations with the lowest educational requirements are expected to show declines.

Our standards of living will continue to rise. The income pyramid will become top heavy changing from a pyramid to a pot-bellied stove. There will be smaller proportions of the population in the lower income levels.

By the year 2000, we may have a population of 325 million, a gross national product close to $4 trillion, and family consumption averaging about $15,000 per annum at present prices.

The effects these changes will have on attitudes toward old-age income assurance and the design and performance of our retirement programs is difficult to foresee. Our present system of day-to-day improvements in pension plans made or bargained for in the market-place has many advantages over any sweeping Federal design for charting the levels of all future retirement pay.

We will see a larger growth in individual savings, investment, and insurance and in employee benefit plans. This will probably be accompanied by a continuing effort to introduce more flexibility into the entire package of employee benefits so that the benefits provided (or selected) will more closely match the increasingly specialized needs and demands of individuals and families. Social insurance cannot, of course, provide this flexibility to meet individual, family, or special group demand.

Our private programs, both individual and corporate, to provide retirement income are an important source of savings. These institutionalized savings are efficiently allocated in our economy as new capital funds. They increase productivity, assure economic growth, provide for full employment, and help maintain price stability. To a large degree, these features are lacking in social insurance programs for the redistribution of income.

We have been warned by Prof. Simon Kuznets of Harvard in his monumental study entitled, "Capital in the American Economy: Its Formation and Financing," that the demand for capital over the next several decades will be large and that our supply of voluntary savings may not be adequate to meet this demand. Certainly, the economics of change outlined above support this finding. In the concluding comments to his study, Professor Kuznets wrote:

"First, the demand for capital over the coming two and a half to three decades is likely to be large. Second, drains upon the national product for current consumption by governments will continue to be proportionately sizable and may well rise. Third, high levels of consumption and the high secular propensity to consume by individuals and households are likely to continue. Fourth, under the circumstances, the supply of voluntary savings may not be adequate. Finally, inflationary pressures may well continue, with the result that part of the savings needed for capital formation and government consumption will be extracted through this particular mechanism. Yet, extrapolation of inflationary pressures over the next 30 years raises a specter of intolerable consequences, making the policy solutions adopted critically important; and those solutions, in turn, will affect the structure and pattern of financial intermediaries and their role in financing."

It appears obvious that from the standpoint of our national goals, Government policy should support those private mechanisms used to provide retirement income which also help to provide the capital needed for economic growth. At the same time, public policy on social insurance programs to redistribute and maintain income will need to be reviewed to determine their value in an affluent economic environment where cyclical fluctuations are satisfactorily controlled. Social insurance programs developed earlier in this country when there was more scarcity and wider swings in the business cycle may not work efficiently as our economic growth continues.

It is most difficult to explain these economic facts to the average citizen. How do you explain to the grandfather who is retiring today on a private pension, that the funds accumulated over the years to guarantee his pension have also contributed to the economic growth of the country so that his grandson just out of college or high school will be able to find a job in the private sector of our economy? At the same time, how can you explain to this same grandfather that, despite the fact that he has paid social security taxes for 30 years, it will be his grandson's social security taxes that will help make up the grandfather's social security checks that he will receive for the rest of his life? This raises the political question. The difference between a corporate pension backed by funds held in trust and the social insurance promise backed by the ability to collect future taxes is quite distinct. There is no question, however, which side could outpromise the other in a promising contest for old-age income benefits.

The Value of Research

The need for further research in the areas of old-age income assurance and in the entire field of economic security assumes more importance. In addition to answering many questions, this symposium will point the way to much needed research. Indeed, further research may be the most significant way to sharpen our understanding of the real issues and alternatives in providing income maintenance.

For example, the real test of our old-age assurance programs is in both the manner in which they are meeting the needs of the aged and the degree to which they are improving from year to year. We do know that among our entire elderly population, the group that has retired in the sixties has better retirement provisions than those who retired in the fifties; and those who retired in the fifties were better off than those who retired in the forties. We do, nonetheless, need more research and statistics on the year-to-year improvements in benefits received by each annual class of retirees. We need better projections of the future progress we have already guaranteed with our present programs.

The Need for Restraint

During the 20th century as our free society has progressed from depression toward affluence, there has developed a need for a national dialog on issues and alternatives in the field of economic security for the individual and the family. A key part of this discussion involves old-age income assurance goals for our present and future elderly citizens. In addition to the dialog, there is a large need for further

research and study to give us the facts necessary to more clearly define the alternatives before us.

Our present approach to economic security is pluralistic. We have a mixed system of social, employer and individual efforts and programs. One of the major issues is: *How will responsibility for the economic security of the individual be shared by government, the employer, and the individual himself?* This and similar issues have serious social, economic, and political implications. The issues must be considered in the light of our national goals of economic growth, full employment, and price stability.

Since economic security provisions involve all Americans from the newest baby to the oldest citizen, we must take into account the economic changes that will occur over long periods of time. We need to continue public policy that encourages economic security programs that help in the formation of much needed capital. The manner in which inflation and increased taxes destroy economic security achievements needs to be reviewed. Support is needed for the appropriate use of fiscal and monetary policy that will control inflation which is so destructive of the values of the retirement income received by the elderly.

We need to critically reexamine all of our social insurance and welfare programs to determine whether they can continue to operate efficiently as methods of income redistribution in our new affluent economic environment. Of major importance is the degree of priority we should give to new or enlarged social insurance programs. The share of national income that should be allocated for public assistance and social insurance—and whether to increase or decrease the amount—poses a serious question. We need to list the inadequacies of social insurance in providing for highly individualistic needs; the limitations of private security mechanisms to fulfill the social needs of low income or nonincome groups; and what the public interest requires as a reasonable mix of both public and private approaches. Since these issues are so vital, there is need for restraint on the part of all those who join in the dialog.

Thus far, with our pluralistic approach, we have achieved the highest levels of economic security for the individual and the family ever known. Some believe that what has succeeded so well is being threatened.

The threat to our uniquely American system comes from the exponents of total security for the individual provided by government through social insurance based on pay-as-you-go tax redistribution. This Great Welfare Society would offer one layer of protection. There would be no employer provided layer and no individually provided layer. The Government would provide for all the economic hazards faced by the individual. In doing this, taxes on corporations could be so heavy that little in the way of fringe benefits could be offered. Furthermore, withholding taxes would be so heavy on the individual, he would tend to consume all take-home pay and have little, if anything, left for savings.

More social insurance programs and more Federal control of corporate and individual efforts to provide economic security could deprive us of the economic growth we need and undermine our capacity

to sustain and improve our present corporate and individual economic security programs and plans.

Our private enterprise economic system has provided our citizenry with the highest income and standard of living that has ever existed. Social security and private pension plans and related fringe benefits will be improved and will continue to help the individual and the family meet their economic security needs. It is imperative, however, that management have discretion in providing pension and other fringe benefits.

If the Federal Government were to "take over" the private pension system, or stunt its growth, then the way would be clearer for total welfare state concepts to be used. The implications for individual initiative, limited government, collective bargaining, and the private enterprise economic system are obvious. The ultimate question is whether the Federal Government should completely control both public and private plans for retirement. If it does, then after a lifetime of work, the average retired American may find his financial income and freedom dependent on year-to-year decisions made in Washington.

It is equally imperative that the American citizen retain the freedom to manage the economic value of his life beyond the floor of protection offered by the Federal Government and the employee benefits provided by his employer. A complete takeover by the Federal Government of control of all retirement income could destroy this freedom. Without such individual economic freedom, there would be no political freedom—no free society.

NATIONAL ASSOCIATION OF MANUFACTURERS

The National Association of Manufacturers appreciates the invitation of the Subcommittee on Fiscal Policy of the Joint Economic Committee to present its views on the private pension plan system and, in particular, the committee publication entitled *Old Age Income Assurance: An Outline of Issues and Alternatives.* The NAM is a voluntary organization of many thousands of member companies located in every State. The views expressed by the association represent those of a broad cross-section of American industry.

NAM believes that private employee benefit plans with their inherent flexibility to adapt to the almost infinite requirements of employees and employers should be encouraged to grow and prosper within a favorable Government policy and climate. Needless Government intervention can curtail their present significant contribution to both individual economic security and to the entire economy.

INTRODUCTION

The past 25 years have witnessed a remarkable growth of retirement programs, both private and public. While many companies have had private pension plans, some dating back more than 50 years, the greatest growth in these plans has occurred in the years since 1940. At that date, about 4 million employees were covered under private pension programs. Today the total is over 25 million. Similarly, since 1940 combined employer-employee annual payments into private pension plans have increased from $310 million to an estimated $7 billion at the present time. Benefits paid have moved upward just as rapidly—from $140 million in 1940 to $3.04 billion. Reserves held by private pension plans have grown from $2.4 billion to approximately $85 billion.

During the same period, the growth of the Federal OASDHI system (Old Age, Survivors, Disability and Health Insurance), hereinafter referred to as "Social Security," has matched or even exceeded the growth of private pension plans. Commencing as a modest program and supported by taxes of 1 percent each, paid by both employer and employee on the first $3,000 of wages or salaries, the program has been expanded by a series of amendments involving coverage, benefits, and rates.

Social security coverage initially was limited to workers in commerce and industry (except for railroads). Over the years, however, coverage has been expanded to include practically everyone except those covered under Railroad Retirement and Federal, State, and local government plans. For example, coverage now includes all self-employed—commercial, farm, and professional—and practically all farm and domestic workers. Originally limited geographically to the continental United States, Alaska, and Hawaii, it now includes residents

of Puerto Rico, residents of most other U.S. overseas possessions, as well as certain U.S. citizens who work overseas.

Maximum individual monthly social security benefits have been increased from $85 to $168, and tax rates and tax bases have been increased from the combined employer-employee tax of 2 percent on a $3,000 base to a combined tax of 8.8 percent on a $6,600 base at the present time. The end is not yet in sight. Combined employer-employee tax rates on the present $6,600 base are projected to be increased to 11.3 percent by 1987. However, if current proposals to increase the benefits substantially (perhaps by as much as 20 percent) are enacted into law, this will almost certainly require a substantial increase in the tax base, the combined rates, or both, in order to finance the expanded benefits without resort to general revenue financing.

The growth of private programs has drawn increasing attention from the Federal Government. To a considerable extent, the attitude of the Government has been critical in nature. At the same time, industry is concerned with the rapid growth of social security. There is an increasing possibility that the social security system's built-in governor—the absence of general revenue financing—may be lost. In this process, a runaway public system—speeded up by general revenue financing—could preempt private effort. Industry is also concerned over the rules of integrating social security benefits with private pension and retirement benefits, and with the actuarial principles on which the social security system is based.

The Staff Report

This commentary by the NAM is a response to a recent congressional publication entitled *Old Age Income Assurance: An Outline of Issues and Alternatives*. The publication, which was released in November 1966, was prepared by the staff of the Joint Economic Committee for the Subcommittee on Fiscal Policy which had held hearings in the spring of 1966 on the subject of old-age income assurance. It is hereinafter referred to as the "staff report," or simply the "report."

The covering letters describe the staff report as a "draft" document, designed to assist in promoting useful debate. In fact, it is a highly critical evaluation of practically all aspects of private pension plans and some aspects of the public system which it would enlarge and expand at the expense of the private. The staff report offers a list of alternatives to the present system, some of which, if adopted, would drastically change the structure of old-age income assurance. Included among these alternatives are guaranteed annual income for the aged through the tax system, a two-tier OASI system with a voluntary supplementary plan, a central pension credit clearinghouse to facilitate transfers of credits among private plans, a central reinsurance agency to reduce funding requirements, stiffening the tax treatment of private plans, and much stricter regulation by a public agency.

Behind all of these suggestions is the premise that the present old-age income assurance is inadequate not only in degree of coverage, benefits, etc., but also in basic structure. Thus, the staff report departs from the report of the President's Cabinet Committee entitled *Public*

Policy and Private Pension Programs released in January 1965. The latter criticized some operational aspects of private plans but attested to their important role in providing retirement security to an increasing proportion of the labor force and concluded that public policy should continue to provide appropriate incentives to the growth of private plans.

The primary purpose of this paper is to examine carefully the assumptions behind the staff report which led to such sweeping proposals for change, and to reply to its specific criticisms. Underlying the staff report's criticisms of private pension plans and, indeed, the principal reasons advanced to justify more intervention in this area, are three basic assumptions:

1. Private pension plans are the recipients of tax favoritism.
2. They are insufficiently regulated at the present time.
3. Pension benefits should reflect the individual's total service to society.

In addition, specific attacks on the private pension system are set forth in the second paragraph of the report, which also serves as its summary:

"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 or 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."

(Italic supplied.)

The first two criticisms—that the system is neither fair nor efficient and that its cost exceeds its benefits to the aged—are generalized objections to the whole complex of devices presently used to assure income in old age. To the extent that these two criticisms apply to pension programs, they are covered specifically in the italicized part of the paragraph. This commentary will later deal with the points of objection, one by one. At this stage, however, it is appropriate to examine the three basic assumptions which led the staff to the quoted conclusions.

The Myth of Tax Subsidy

The report implies that much of the growth of private pension plans can be attributed to special incentives in the Federal tax law. This same argument is incorporated in much of the testimony by Government witnesses at the hearings conducted by the Subcommittee on Fiscal Policy of the Joint Economic Committee. Indeed, one is struck by

the frequent and fundamental assertion of "preferential" tax treatment of private plans. This alleged subsidy is said to arise from "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 implication is that the alleged subsidy justifies greater Government involvement and policy determination concerning the form, scope and other features of private plans. Other reasons for greater involvement are stated, but the dominant thought seems to be the interrelation between tax subsidy and control.

A review of the history and nature of the tax treatment of private pension plans indicates that the "subsidy" concept is greatly overstated. Instead, the fair conclusion is that the tax law provisions are reasonable and practical in light of the nature of the transactions involved in private pensions. In fact, these provisions have tended to impose limitations and restrictions on the development of private pension plans, a far different matter than providing a subsidy to encourage their development.

For example, limits were placed on the deductibility of contributions for past service cost as far back as the 1920's. They had to meet the test of reasonableness and the 1928 Revenue Act limited their deductibility to a period of not less than 10 years. The nondiversion rule was added by the Revenue Act of 1938 and provided that a pension trust had to be irrevocable and the funds had to be used for the benefit of the employees. The Revenue Act of 1942 added the so-called nondiscriminatory feature to the law which provided that plans should not favor highly compensated employees. It also introduced a limit to the annual tax deductions for contributions to qualified plans.

In its assumption of a tax subsidy (sometimes described as a tax incentive, a tax advantage, or favored tax treatment or status), there is some implication in the report that a tax incentive is involved in both the deduction by the employer of contributions to the retirement fund and the delay until retirement of treating these contributions as income to the employee. However, these tax effects are consistent with the nature of the transaction.

The employer's contribution constitutes an irrevocable payment solely for the benefit of employees. In determining the employer's net income subject to tax, it is immaterial to him whether the amount is paid as a pension contribution or as wages. It is an ordinary and necessary business expense, clearly deductible under the income tax law before any special rules were enacted. Such a deduction is no more a tax incentive than is a deduction allowed for a wage payment.

Similarly, the attribution of tax to the employee only when he receives the employer's contribution in cash is reasonable and far from a subsidy. In the case of wage compensation, the employee receives immediate spendable income in cash. But the employee has no right to income at the time the employer makes a pension contribution. Even with immediate vesting, the employee generally cannot withdraw the vested portion until retirement. Thus, no current taxpaying capacity is created; the employee only has a right to future benefits if and when he becomes eligible to receive them. Under many plans, no employer-financed benefit accrues to his estate if an employee dies

before retirement. But in any event the forebearance of tax until income is received is a matter of tax timing and not tax exemption.

The attribution of subsidy to these situations apparently derives from a comparison with the tax treatment of other types of income. As compared with wages, for example, it is true that the employer's payments are deductible and the employee's income taxable at the same time. But the fact that this applies with respect to wage or other income does not establish that it should also apply to pension income.

It is true that income of a qualified trust is not taxable, but in light of the restrictions already imposed as a condition of qualification and the nature of the transaction, this exemption does not justify further control of pension plan operations. Although the trust may have earned income, the employee may not receive it until a much later time. And even if an employee's rights are vested, he has no claim to income until he has actually retired and it would work a hardship in many cases if the tax was not postponed until that time. In simple trusts a deduction is available to the trust in the year of distribution for the amount of distribution actually made, and thus there would be no tax on income to the trust. The same policy considerations should apply in the case of employee trusts.

Therefore, instead of special privilege we thus have a situation in which pension income is taxed in accordance with the nature of the transaction involved. The transaction differs from the current receipt of wage payments and other types of income. A tax law which does not take cognizance of such differences would be unrealistic and inequitable. Perhaps more importantly the Government interest in control of these plans has already been exercised in far-reaching measures which should not be extended further, at least until the necessity of increased control has been demonstrated.

The recognition in tax law of an established practice, condition, or contractual arrangement is far different from application of a tax law to induce or suppress a particular activity. Such recognition merely permits the taxpayer to continue to do what he has been doing, or what he would do except for inhibiting taxation. It is not accurate to describe such permissiveness as constituting an incentive, or involving a subsidy.

The fact that the tax treatment of private pensions is consistent with the nature of the pension arrangement is confirmed by tax policy elsewhere. The more than 6 million Federal Government employees are not taxed currently on their employer's contributions. This is also true of the almost 9 million State and local government employees. Trust fund income likewise is not taxed under these plans until disbursed as pension income.

The social security and railroad retirement systems go further than these plans and exempt from tax not only the employer's contributions and trust fund income but all retirement payments as well. However, some measure of equality with the social security and railroad retirement beneficiaries is achieved for pensioners under other plans by use of the retirement income credit.

Taken together, all of these situations add up to a consistent rule of taxation. instead of a departure justifying an allegation of special privilege. The rule is that the natural time to apply a tax is when income is received, just as the time to deduct an expense is when the

expense is incurred. The *forebearance of tax until income is received is a matter of tax timing and not tax exemption.* It simply is not realistic to consider that any kind of subsidy results because a tax is not incurred until income is received.

The report also advances the old argument:

"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."

This is about as absurd as it would be to claim that taxpayers pay 48 percent of the bill for wages and salaries of private employers, which are also deductible in computing taxable income. By this philosophy, corporations should be hoping for higher tax rates which would enable them to shift more of their labor costs onto the shoulders of other taxpayers.

There is no validity to the view that tax treatment of pension arrangements is a Federal subsidy.

The Case for Further Regulation

Qualified pension plans have for many years been subject to a considerable degree of statutory and administrative regulations. The principal regulatory body is the Internal Revenue Service.

The volume of regulations, rulings, and official publications dealing with employee pension plans attests to the degree of attention and supervision directed to this subject. For example, in order for a plan to be qualified, the regulations under the Internal Revenue Code now provide:

1. There must be a trust, contract, or other legally binding arrangement.
2. The plan must be in writing and communicated to employees.
3. There must be a permanent and continuing program.
4. The plan must be for the exclusive benefit of employees.
5. Pension funds cannot be used other than for the exclusive benefit of employees and their beneficiaries until there has been complete satisfaction of all liabilities to employees and their beneficiaries.
6. The plan must not discriminate in favor of employees who are officers, shareholders, supervisory employees, or highly compensated employees.
7. The plan must provide definitely determinable benefits.
8. The funds of a pension plan are to be held only by a life insurance company or a trustee acting under a properly constituted trust.
9. All contributions made by the employer are irrevocably committed to the pension trust.

Illustrative of the review and supervision which qualified pension trusts receive from the Internal Revenue Service is a quotation from the testimony given by the Commissioner of Internal Revenue at the hearings before the Fiscal Policy Subcommittee of the Joint Economic Committee:

"Consistent with the requirement that a plan be maintained for the exclusive benefit of employees, investment of trust funds must meet

certain criteria. These are: (1) the cost of an investment must not exceed its fair market value at time of purchase, (2) a fair return commensurate with the prevailing rate must be provided, (3) sufficient liquidity is to be maintained so as to permit distributions in accordance with the terms of the plan, and (4) the safeguards and diversity that a prudent investor would adhere to must be present.

"Furthermore, a trust may lose its exemption if it engages in a prohibited transaction in dealings with the employer, or related or controlled interests. These consist of: (1) loans of trust funds without the receipt of adequate security and a reasonable rate of interest, (2) payment of compensation in excess of a reasonable allowance for personal services, (3) making any part of its services available on a preferential basis, (4) buying securities or any other property at a price in excess of fair market value, (5) selling securities or other property at a price below fair market value, and (6) engaging in any other transaction which results in a substantial diversion of trust income or corpus.

"An exempt trust is required to file an annual information return, Form 990–P, reporting its financial transactions and furnishing a statement of receipts and disbursements and a balance sheet. Furthermore, if it has unrelated business taxable income, it is required to file a tax return, Form 990–T, and pay the applicable tax. These returns are subject to examination in accordance with our audit procedures."

In the administration of pension plans, the Internal Revenue Service is entrusted with a high degree of discretion in determining whether it will approve either initial plans or subsequent amendments. The justification for this high degree of discretion is based on the Congressional concern that the plan should not discriminate in favor of stockholders, officers, or highly paid employees. In many instances, however, the pension plan specialist who reviews a plan or its amendments may insist upon changes in the plan to conform to his own ideas of what the plan should provide. This frequently occurs where there is no possibility of discrimination. To obtain approval of the plan, the employer must, nevertheless, accede to the changes required by the pension trust specialist.

The Federal Welfare and Pension Plans Disclosure Act also requires the filing of plan descriptions and disclosures of pension plan operations. It contains requirements for the bonding of administrators and grants investigatory, enforcement, and rulemaking authority to the Secretary of Labor with respect to disclosure—coupled with severe penal sanctions for fraud.

Finally, additional regulation may come into play through the Federal Reserve, Comptroller of the Currency, Federal Deposit Insurance Corporation, Securities and Exchange Commission and the various State insurance and banking commissions. Nor is regulation confined to governmental bodies. The most recent body to make its views known is the American Institute of Certified Public Accountants. Accounting Principle No. 8 devotes itself to the matter of what will and will not be acceptable in the way of annual balance sheet accounting for private pension plans costs.

It is clear from the above that private pension plans are already subjected to a substantial degree of statutory and administrative regulation.

Pension benefits should reflect the individual's total service to society rather than his services to any particular employer or employers.

The report reluctantly concedes that the community's commitment is very strong to a pension system based on the individual's past work, rather than on the mere fact that he is old. But it goes on to say:

"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."

This is a very strange statement. It calls into question the whole basis of a private enterprise system of economic organization. When an individual offers himself for employment, he expects to be compensated on the basis of his contribution specifically to that firm's interests—not on some vague basis described as "service to society." And, as a matter of fact, we have found that society is best served when arrangements are made on the basis of two-party bargains where each party is governed by his own interests. Socialist societies, in which everyone's activities are supposedly oriented toward the general public interest, are not among the most successful ones.

Pension systems are still evolving and they will undoubtedly continue to expand and improve. But there is no reason to interfere with the freedom of employers and employees to agree on the pension arrangements which seem most desirable in each particular case.

In developing its argument on this point the report finally turns for support to its earlier assumption that pension plans are subsidized by their tax treatment. We have already seen that the argument that pension plans are "tax supported" is invalid.

STAFF REPORT'S SPECIFIC CRITICISMS

We now return to the specific criticisms of the private pension system that have been summarized in the paragraph previously quoted. The report finds that pension plans:

1. Generate unfulfilled expectations
2. Impede free choice in employment
3. Impede free choice in saving
4. Induce excessive saving
5. Create enclaves of economic power
6. Hinder the productive deployment of wealth

We will comment on each of these points.

1. GENERATION OF UNFULFILLED EXPECTATIONS

An employee's pension expectations depend largely on the care he has devoted to understanding his company's pension system. Many employers go to great lengths to ensure that those covered have information as complete as possible. Employees should have available to them a complete explanation of their rights and obligations, together with the employer's and trustee's responsibilities under the plan.

In fact, this information is required by the Welfare and Pension Plans Disclosure Act of 1958, as amended. This Act is designed to

effect honest and responsible administration of private employee benefit plans by requiring reporting and disclosure of financial and other information. A description of each plan must be filed with the Department of Labor by the plan administrator. Upon request to the plan administrator, each plan participant and beneficiary is also entitled to a description of the plan. In addition, each plan must file an annual financial report.

2. IMPEDING FREE CHOICE IN EMPLOYMENT

The criticism that a private pension plan impedes a worker's free choice in employment is puzzling. If it simply means that an employee may, because of his pension situation, prefer one employer to another, it is, of course, true. Complaining about this is like arguing that free choice is impeded by the fact that some companies are more attractive places to work than others.

Many companies have established pension programs with the specific purpose of holding their work force together. There seems to be nothing illegitimate in such an objective. Surely no one would think it amiss if the company tried to hold its employees by raising wages or by improving working conditions.

3. IMPEDING FREE CHOICE IN SAVING

Apparently the point of the crticism that free choice in saving is impeded by private pension plans is that individual members of pension plans might have preferred, if the contribution made on their behalf had been put completely at their disposal, to save it in some other form. Or perhaps they would have preferred to spend it on consumption and not save it at all. Thus, it is suggested, the individual's freedom is restricted.

This line of thought is completely unrealistic. It implies that any company, when offering a benefit to its employees, is restricting their freedom unless it offers a complete range of options for equivalent benefits they might prefer. Perhaps one employee would prefer a longer coffee break to the pension program. Does the company, in the name of preserving his freedom, have to allow him to make this choice?

Also, a very substantial portion of the pension plans in existence in this country have been negotiated by labor unions which have been selected voluntarily by employees. To the extent, therefore, that pension plans result from labor union negotiations, it can be accurately stated that the employees covered have chosen this particular method of saving.

Actually, freedom is preserved by maintaining a number of alternative opportunities for employment. A worker can choose a company with a different type of pension program if he would rather do his own saving in some other way. Of course, the social security system provides no freedom of choice whatsoever with respect to saving.

4. INDUCING EXCESSIVE SAVING

In the view of the report, funded private pension plans lead to oversaving and hence threaten us with a condition of chronic economic

stagnation. This is the central point in the report's criticism of the private pension system.

Unlike the social security system, which depends for its existence on the continued power of the Federal Government to tax, a private pension plan must create a fund from which pension promises can be paid regardless of the continued profitability or existence of the employer. Also unlike social security, current costs of a private pension plan are current charges against production and should be charged as the costs are incurred and not deferred only to be charged against future managements of the company.

The view that oversaving is a leading threat to economic growth was prevalent in the 1930's but has fallen into disrepute in more recent years. But it apparently still has its adherents:

"* * * 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 subtracts from the capital stock by depressing demand for output and the motive to invest."

What the question comes down to is this: Where does the greater danger lie in the future? Is it in the likelihood of oversaving—the fear that saving may exceed the opportunities for investment and hence by simply a withdrawal of purchasing power that depresses the general level of economic activity? Or does the danger lie in the probability of undersaving—the fear that saving may not be adequate to meet the needs of capital formation and hence may retard economic growth?

The fact is that this is an enormously complicated question for economic analysis, on which there is still room for disagreement. One may concede that either oversaving or undersaving are possibilities in the abstract. The concrete queston is, given present and foreseeable circumstances, which presents the real threat in the future? The most thorough-going treatment of that question is the volume *Capital Formation in the American Economy, Its Formation and Financing*, prepared by Dr. Simon Kuznets for the National Bureau of Economic Research in 1961.

It is impossible in this space to summarize all the material prepared by Dr. Kuznets having a bearing on the oversaving versus undersaving argument. His conclusions, although they are not dogmatically stated, on the whole favor the belief that undersaving is the danger for the future.

Since funded private pension plans contribute to the total of voluntary saving, they will help in the future attainment of economic growth and stability, rather than interfere with it as the report maintains.

5. CREATION OF ENCLAVES OF ECONOMIC POWER

It is difficult to comment on criticisms of pension plans as enclaves of economic power, since such criticisms are interlarded with emotional statements of personal prejudices. The report starts off by a gratuitous slap at the insurance industry:

"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."

Later it advises unions not to let themselves be "caught up in the chicane of high finance." Despite its desire to maintain competition among fund managers and plan administrators, it thinks there are too many independent plans in existence. Its conclusion is that: "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." Again:

"* * * 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."

Aside from these statements of personal views, the point seems to be that those who control pension funds, and administer the benefits paid out of them, acquire considerable economic power. They have power over employees in making decisions on benefits in doubtful or marginal cases. They acquire powers in the marketplace through the control of large funds.

The limitation on power in our kind of society is competition. The report brings forth no evidence to show that insurance companies, and other financial firms, do not compete effectively with each other for the management of funds. As for nonfinancial companies which manage their own funds and administer their own plans, they are presumably in competition with other firms both for customers and for efficient employees. Their ability to succeed depends on their efficiency in all phases of management, including pension administration.

6. HINDRANCE TO THE PRODUCTIVE DEPLOYMENT OF WEALTH

The argument is made in the report that the existence of funded pension plans results in a misallocation of capital and constitutes a hindrance to the productive deployment of wealth.

It is difficult to make sense of this argument. The report seems to agree that fund savings are a net addition to the national saving, rather than a substitute for other kinds of savings that would have taken place in their absence. If this were not so, the report could not make its other argument that pension funds threaten us with oversaving. Therefore, savings through pension funds result in a net addition to the capital facilities of the Nation—over and above what would otherwise exist—no matter how badly they are misinvested.

At one point, the report argues that pension funds misdirect the flow of capital by concentrating too much on low-risk securities and that it would be in the interest of all concerned if such capital went into riskier high-yield situations. Later, it contradicts this argument by suggesting that the use of internal business funds may misallocate capital and it would be better to channel them through pension funds. The report contradicts itself once again by complaining that, instead of being too conservative, pension funds may be too eager to make gains through stock market speculation.

It is, of course, impossible to answer all these contradictory criticisms. The point is that pension funds are able to make use of all the various institutions that make up the American capital market. That market has a universal reputation for being the most efficient market in the world for channeling savings into productive uses.

Although not all of the points made by the staff report have been examined in the foregoing commentary, the remainder are of the same general character and share the same lack of substance.

PUBLIC PENSION PLANS

As we have seen, the staff report has been critical of private pension plans and is concerned over the relationship between the private and public retirement systems. The report is sweeping in its apparent indictment of private plans and implies that their continued existence is justified only where they are made to satisfy public interest criteria—whatever that may mean. It attests to the virtues of the public system of providing for old-age income assurance through the old-age features of the social security system.

Although in a broader sense public pension plans also include railroad retirement, U.S. civil service, Foreign Service, TVA, Federal Reserve, and the State and local plans, public pension plans will be limited to the Federal social security system in the following discussion.

In any consideration of the social security system, it is important that its true nature be defined, since it differs materially from private plans. Although it has been expanded to provide almost universal coverage, and there is complete portability of credits earned, it is not in any sense of the term "insurance"; that is, there is no contractual right against the Government to enforce its benefits. Furthermore, unlike pension plan benefits which are payable without regard to other income of the pensioner, social security is a "retirement" system—not a pension system. This is so because of its so-called work test which, with respect to persons under age 72, reduces their benefits if they have earned income in excess of $1,500 per year. It requires only a moderate amount of earned income to eliminate social security benefits entirely until such time as the individual has reached the age of 72, at which time the work test is no longer applied. While the staff report would eliminate the work test, the cost of such a change has been estimated to be approximately $2 billion per year.

Social security was conceived as a compulsory basic retirement system and it was originally the intent to impose taxes high enough to accumulate a substantial reserve. This original idea was quickly abandoned, and the system has been operated for many years on essentially a pay-as-you-go basis with current revenues being roughly equal to current expenditures. As a consequence of this process, a substantial unfunded past service liability has been created, many estimates placing it in excess of $400 billion at the present time. Inevitably, this past service liability will grow since extensions of coverage and benefits over the years have invariably preceded tax rate and base increases sufficient to keep the system on an actuarially sound basis.

The fact that early retirees under the system have enjoyed substantial subsidies—the value of their retirement benefits being vastly in

excess of the total of the payments into the system for their account—produces a result whereby the discounted value of presently scheduled benefits to later retirees is less than the taxes that have been imposed upon them and their employers.

For example, on a taxable wage base of $6,600 today, the employee and employer are each taxed $290.40 per year. Ignoring the future increase already projected, the yearly total of $580.80 would, if accumulated at 4-percent compound interest, grow to $55,191 over a 40-year period. Thus, a worker aged 25 at the start of the accumulation period would have contributed—or had contributed for him—an accumulated fund at age 65 in an amount sufficient to pay the accumulated cost of survivor and disability benefits (estimated at 20 percent of the total), and still have left a fund of $44,153. Based upon today's annuity rates, that sum would be sufficient to purchase a life annuity from an insurance company in the amount of $332 per month. Contrast this to the current social security maximum benefit of $252 per month. And that maximum benefit of $252 cannot be realized until the year 2004 and then only if future tax increases up to a combined 11.3 percent are put into effect (present total annual tax of $580.80 results from a combined tax rate of 8.8 percent), and is payable in that maximum amount only so long as both the retired worker and his spouse are both alive.

This predictably (and understandably) leads to constant pressure to expand benefits, since anyone approaching retirement age is justified in insisting that his taxes have been given to the support of others who have already retired, and that it is only fair and equitable that a succeeding generation of taxpayers take care of him. This pressure to increase benefits, which is greatly intensified by inflationary trends, requires corresponding increases in the payroll tax rates and in the wage bases on which they are imposed.

As a consequence, the Nation is approaching several basic limits in this area, which are:

1. The extent to which future generations can be expected to contribute to the social security system.
2. The extent that future national income can safely be set aside for public retirement purposes without impairing capital formation and growth.

Since the only "asset" behind the Government's undertaking to pay social security benefits is its power to impose larger and larger taxes upon future generations of taxpayers, the principal area of danger lies in the continued liberalization of the benefit structure. The system may already be vulnerable in this respect.

We should not lose sight of the original purpose of the social security system which was to pay benefits to retired workers and their families. It should retain its character as a basic public retirement system and should not be expanded to include welfare payments of various types. The financing of the system should continue to be through payroll taxes—not by resort to general revenues.

If public and private plans are to coexist and if, as suggested above, the expansion of the social security system is approaching a level beyond which it would be unwise to go, it follows that the principal means by which old-age income assurance could be expanded is through private pension plans.

SUMMARY AND CONCLUSIONS

The vigor and efficiency of private pension plans is confirmed by their growth. Coverage, vesting, and benefits have constantly been improved by free interaction of competitive forces. Competition in a free society being a principal motivator, present trends toward earlier vesting, greater funding, and broader coverage will continue. Because of the diverse needs and circumstances of various industries and economic sectors of society, further improvement of private pension plans will best be effected through voluntary action and labor-management negotiations—not through rigid formulas imposed by law or Government regulation.

The argument that private pension plans are recipients of tax favoritism and therefore should be subject to substantial new Government controls is without merit. The existing treatment of private pensions is consistent with broad tax policy and confers no special privilege or subsidy. Private pensions are already subject to many existing statutory and administrative rules which provide responsible fiduciary practices and equitable treatment of employees.

With respect to the social security system, there are large questions concerning the extent to which future generations can be expected to contribute to the system and the extent that future national income can safely be set aside by fiat without impairing capital formation and economic growth.

Social security should retain its character as a basic retirement system which is financed by contributions by employers and employees. But the primary means by which old-age income assurance should be further expanded is through the more flexible arrangements of private pension plans.

PRIVATE PENSIONS AND THE PUBLIC INTEREST*

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FOREWORD

This paper is divided into two parts. PART ONE discusses the subject of private pensions in our society. PART TWO discusses the McClung report.

> *Note:* While the term "private pension plan" is used extensively in this paper, it is also meant to describe deferred profit-sharing plans in their role as pension plans; the term "Social Security"—as used in this paper—is used to describe the retirement portion of the old age, survivors and disability insurance system.

EDITOR'S NOTE

The McClung Report has caused a great deal of consternation. It is, however, important that the document authored by Dr. McClung be put into proper perspective. Probably the best evaluation of the Report is in Dr. McClung's own words, as described in the Spencer *Weekly News Digest:*

> "Although many of those in attendance (at the Midwestern Pension Conference) were 'out for blood,' Mr. McClung shocked them into immobility by his frank answers to the first two questions:
> Q: 'What data did you use in preparing the staff report?'
> A: 'None.'
> Q: 'Are the assertions in the staff report based on fact or assumptions?'
> A: 'Assumptions, of course.' "

*A special report prepared for the Eastman Kodak Co. and Marion B. Folsom, Director, by Towers, Perrin, Forster & Crosby, Inc.

Part One—PRIVATE PENSION PLANS

The economic and social impacts of private pension plans and their funds have caused a great deal of interest—and some concern—in various segments of the Government. This interest is personified by the growing influx of pension-related bills and resolutions into congressional hoppers. Other expressions of interest are demonstrated by such Government-sponsored papers as *Public Policy and Private Pension Programs* (The President's Committee Report on Private Retirement Plans) and *Old Age Income Assurance: An Outline of Issues and Alternatives* (The McClung report). Undoubtedly this interest will become even more intense in the near future as private pension plans—and their funds—continue to increase.

HISTORICAL BACKGROUND

Private pension plans are a relatively modern social and economic innovation. As described by Melone and Allen in their book, *Pension Planning:*

"The beginnings of industrial pension plans in the United States date back to the establishment of the American Express Co. plan in 1875. The second formal plan was established in 1880 by the Baltimore & Ohio Railroad Co. During the next half century, approximately 400 plans were established. These early pension plans were generally found in the railroad, banking, and the public utility fields. The development of pensions in manufacturing companies was somewhat slower, due largely to the fact that most manufacturing companies were still relatively young and, therefore, not confronted with the superannuation problems of the railroads and public utilities.

"Insurance companies entered the pension business with the issuance of the first group annuity contract by the Metropolitan Life Insurance Co. in 1921. The second contract was issued by the Metropolitan in 1924 to an employer who already had a retirement plan on a 'pay-as-you-go' basis. In 1924 the Equitable Life Assurance Society announced its intention of offering a group pension service, thus becoming the second company to enter the field." [1]

One of the first large companies to adopt a group annuity plan was Eastman Kodak Co., which in 1928 established a retirement annuity, disability, and life insurance plan, underwritten by an insurance company.

The underlying reasons why industrial concerns consider pension plans desirable were explained in an article in the September 1929 issue of the *Atlantic Monthly* by M. B. Folsom, treasurer of East-

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[1] Joseph J. Melone and Everett T. Allen, Jr., *Pension Planning* (Homewood, Ill.: Dow Jones-Irwin, Inc., 1966) pp. 1–2.

man Kodak Co., who served on the original Social Security Advisory Council and later as Secretary of Health, Education, and Welfare.

The following are extracts from this article:

"Removing the older man who is no longer able to produce makes way for younger people and has a stimulating effect upon the whole organization. Employers all feel that, up to the age of declining strength, longtime service on the part of many employees is a business asset. An organization which takes adequate care of its superannuated people appeals to the workers. A well-established pension plan undoubtedly serves to attract employees, even at younger ages, who are of a more stable nature, and to that extent affects turnover and the general character of the working force. The reputation of an employer in a community is enhanced by the fair treatment of the older employees, and this is a definite business advantage.

"Good, humane management will not permit employees of long service to be discharged if they have not adequate means of sustenance. Yet good management cannot keep employees on the force when they are no longer productive. The solution is the inauguration of a sound and adequate pension plan."

Private pension plans, however, did not enjoy great growth during the 1930's. As Melone and Allen remark:

"Although the beginnings of private pensions date back to the 1880's, the significant growth in these programs has come since the 1940's. As recently as 1940, *less than one-fifth of all employees in commerce and industry were covered under pension plans.*" [2] (Our emphasis.)

Since 1940, however, pension plans have grown at an extremely fast rate. In 1940, about 4 million workers were covered or about 14 percent of the employees in nonagricultural, nongovernmental institutions. By the end of 1966, about 30 million or more of employees in the same institutions were covered. This represents about 57 percent of workers in nonagricultural and nongovernmental jobs. (Most State and Federal employees are covered under their own systems.)

Historical Tax Background

To best understand one of the reasons for this recent proliferation of private retirement plans, we must look at the Government's Federal tax policy concerning private pension plans. A good description of this fiscal policy is found in the book by Paul P. Harbrecht, S. J., *Pension Funds and Economic Power:*

"From 1913 when the income tax was inaugurated until 1921, employers could treat pension liability accruing in the current year as ordinary business expenses. Amounts contributed to pension funds could be deducted from gross income. *The income from pension funds, however, was subject to the same taxation as any other trust. At the same time retired employees were subject to tax on the pension payments they received. Employees were also taxed during their years of active service on the amount of their employer's contribution to a pension trust for their benefit. Furthermore, there was no exemption of an employer's payments to the fund liabilities for the past service benefits.* (Our emphasis.)

[2] *Ibid.*, p. 2.

"The situation, then, was that the employee was being taxed on the contributions made by the employer for pension benefits which might never be received. The plan itself might be terminated at any time or the worker might leave the job and thereby forfeit all rights to a pension. In these circumstances, employers were discouraged from funding pension plans to meet future liabilities and were also deterred from funding past service liabilities.

"The first exemption favoring pension trusts was incorporated in the Revenue Act of 1921. This act exempted the income of pension and profit-sharing trusts from income tax and relieved employees from the tax on the current contributions made to a trust for their benefit by the employer. There was no relief given for funding of past service liabilities. The provision enabling an employer to deduct a reasonable contribution for past service liabilities over a 10-year period was not made until 1928. At that time employer's contributions to a pension fund were allowed as a deduction from gross income because they constituted a business expense, *even though a company could at any time amend or revoke a plan and divert pension funds to its own use.* The Revenue Act of 1938, however, provided for an exemption only if the wording of the plan made it impossible to divert pension funds from uses other than the exclusive benefit of the employees. (Our emphasis.)

"Advances previously made were preserved in the 1942 Revenue Act in which the pension tax provisions were completely rewritten. The new statute contained much more specific provision for regulating employees benefits in the method of deduction." [3]

Harbrecht's book also gives some other "public" reasons for the growth of private pension plans:

"An analysis of this rapid growth reveals the influences at work in shaping the private pension plans. In a report on welfare and pension plans the subcommittee of the Senate Committee on Labor and Public Welfare gives the following reasons for the rapid growth of pension programs:

"1. During and since World War II, high corporate taxes coupled with tax reduction for contributions to pension funds permitted the establishment of these programs at low net cost.

"2. Wage stabilization programs during and since World War II and the Korean conflict froze wage rates but permitted increased employee compensation in the form of these 'fringe' benefits.

"3. Court decisions in the years 1948–50 made welfare and pension matters a bargainable issue.

"4. Since 1948 the labor unions have put on a drive to obtain welfare and pension programs. Labor spokesmen stated that another reason for the development of these programs has been the inadequacy of benefits under the Government programs.

"A survey of corporate pension funds published by the Securities and Exchange Commission in October 1956 finds essentially the same reasons for their growth. The SEC study goes on to say: 'The chief impetus to pension plan growth, however, was the establishment of old age and survivors' insurance in the middle thirties; at about the same time railroad pensioners also came under the railroad retirement sys-

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[3] Paul P. Harbrecht, S. J., *"Pension Funds and Economic Power"* (New York: the Twentieth Century Fund, 1959), pp. 8–9.

tem of the Government.' It has often been remarked that the Government's program to provide social security benefits made Americans 'security conscious' * * *.

"With the country's social security program providing the psychological setting for the growth of private pensions funds, the Federal tax policy added a strong inducement to set up these plans. A brief history of the Federal tax treatment of pension funds will indicate the formative influence of Government policies upon the development of the pension movement."[4]

Harbrecht's book continues:

"Recent economic developments have also given impetus to the pension movement. During the 1950's, the period in which private pension funds have been growing most rapidly, their assets have been invested to an increasing extent in a rising capital market. *As a result, the earnings performance of the funds has been rewarding and has justified the employers' hopes in establishing and maintaining pension trusts. The growing desire of employers to put the plans for retirement of their workers on a steady and predictable basis has also played a part.*"[5] (Our emphasis.)

(It should be pointed out that Harbrecht is a "critic" of the private pension plan system. In the main, his thesis develops the theory that the vast accumulation of pension funds in the hands of small groups—bankers, insurance companies, trustees, unions, et cetera—organizes a new power structure of men who "control" pension funds that no one "owns." This is one reason why his quotes are particularly significant.)

The Present Situation

As noted previously, private pension plans now cover 30 million or more workers—or about 57 percent of nonagricultural, nongovernmental workers. *In 1966, about 2.7 million retired workers received an estimated $2.9 billion in retirement benefits from private pension plans.* The President's Committee report has *conservatively* estimated that these figures will go up to 6.5 million workers and $9 billion, respectively, by 1980. (Our emphasis.)

The Present Tax Policy

Any attack on the private pension plan system—almost without exception—points to the tax situation of *qualified* pension plans. Under the present Internal Revenue Code, qualified pension plans:

(*a*) Permit the employer to deduct contributions (within certain specified limits) as ordinary and necessary business expenses (as with wages, salaries, et cetera) for Federal income tax purposes;[6]

(*b*) Do not include the employer's contributions in the taxable income of employees covered by plan until the employees actually receive benefits from the plan;[7]

(*c*) Are not taxed on funds accumulated by investment return; and

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[4] *Ibid.*, pp. 7–8.

[5] *Ibid.*, p. 9.

[6] Assuming a 50-percent corporate income tax rate, it would cost an employer $0.50 to put a dollar into a retirement plan.

[7] This point shows the fallacy inherent in the charge that private pension plans avoid taxation; the recipients of private plan benefits *pay a tax* (on both previously deducted employer contributions and untaxed fund earnings) *at the time benefits are received* (as *when normal compensation is received*)—the tax on pension plans is only *deferred* and *not avoided.*

(*d*) Have as one of their chief characteristics the irrevocability of employer contributions—these funds and any investment return on them must be used to provide benefits for plan members.

In a recent speech before the National Association of Manufacturers Employee Benefits Committee (Summit Hotel, New York, N.Y., March 14, 1967), Representative Martha W. Griffiths (Democrat, Michigan) commented:

"The (private pension) system, however, increases the tax contributions of all other taxpayers by approximately $1 billion per year. In addition, the cost of the contributions to the company is included in the cost of the product sold to the general public and thus paid for a second time."

We might logically ask who would have been responsible for paying the estimated $2.9 billion to 2.7 million private pension recipients in 1966? The Government? How would the money have been raised? Through increased taxation? And if the tax policy did not permit the deduction of employer contributions and private pension growth, the companies paying benefits would have passed twice the cost on to the consumer—and how much would this have meant in increased consumer prices and inflation? Finally, since investment return of most pension funds has been good, how much has this investment return helped keep increased prices from being passed on to the consumer because lower funding costs were possible?

The qualification of private pension plans is a strict and formal process. Companies initiating qualified plans undertake definite responsibilities. Before approving pension plans, the Internal Revenue Service requires that the plan—

Be a trust, contract or some other from of legally binding agreement; it must be intended as a permanent and continuing arrangement; [8]

Must not discriminate in favor of officers, shareholders, supervisors or other highly compensated employees and must benefit an establishment's employees in general rather than just a limited number; the plan must cover at least a certain portion of employees or cover various groups of employees (salaried, bargaining group, etc.) which the IRS has determined not to favor officers, shareholders, et cetera;

Must be for exclusive benefit of the plan members and that funds in the plan *must be irrevocably dedicated to provide plan benefits;*

The plan must provide benefits which can be definitely determined.

Reasons for Existence

There are many public and private reasons why private pensions are both desirable and necessary. A few reasons include:

Availability of funds after retirement.—In our society, age 65 is considered the "normal" retirement age. This age is designated in most private pension plans and is the age set by Congress as a require-

[8] While the Treasury Department requires that the plan be in writing, recent practices established by the American Institute of Certified Public Accountants (Accounting Opinion No. 8) for the accrual accounting of pension plan costs also "regulates" "informal" pension practices which are not in writing but which have been communicated to employees or can be *determined* by prior company practices.

ment for receiving full benefits under old age, survivors and disability insurance. Because of the dropoff of earnings at this age, some type of income is necessary. Retirees covered under OASI receive pension benefits related to their coverage and earnings history. Private pensions supplement this income by providing either flat-rate or earnings-related benefits which permit retirees to maintain a reasonable standard of living (as compared with their preretirement standard) and purchasing power.

Humane removal from work force.—The problem of aging, increased deterioration of the body and mind at advanced ages, and the psychological factors of "growing old" affect the productivity of aged workers. An employer can meet these problems in several ways:

By discharge of the aged employee without further compensation;

By continued retention of the employee in his present position and at current compensation;

By continued retention of the employee but transferring him to a less demanding position and to a lower compensation rate;

By establishing and maintaining a formal pension plan.

The first two alternates are not practical or humane. In the first, the aged employee is considered nothing more than a factory implement to be discarded when unproductive. In the second, the employer runs the risk of having a high cost, and many times, unproductive shop. The third alternate presents the employer with keeping or attempting to establish "low productivity" jobs—plus the psychological problems of demotion are great in the aging employee. As Melone and Allen remark:

"The fourth alternative available to the employer in meeting the problem of superannuation is to establish a formal pension plan. A pension plan permits employers to terminate superannuated employees in a humanitarian and nondiscriminatory manner. The inefficiencies associated with retaining employees beyond their productive years are, therefore, eliminated. Employees will know that they are expected to retire by a certain age and they can make the necessary provisions for their retirement. Furthermore, the sense of security derived from the knowledge that provision is made, at least in part, for their retirement needs should increase the morale and productivity of employees. Also, systematic retirement of older workers will keep the channels of promotion open, thereby offering opportunity and incentive to the young, ambitious employees—particularly those aspiring to executive positions." [9]

Competition.—There is an increasing competition in industry for personnel—productive personnel. One of the inducements offered is supplemental remuneration in the form of employee benefits. A retirement plan is one of these inducements for remaining with a company.

Work force stability.—While companies may initiate pension plans to be competitive and attract employees, they also initiate pension plans to retain present employees and reduce labor turnover. This objective is often criticized as reducing the labor mobility of the work force.

Is labor mobility always desirable? Not necessarily. The stability of a regional work force is both a social and economic necessity. Many

[9] Melone and Allen, *op. cit.*, pp. 8–9.

employees *don't want* to be mobile; deep roots in the community are often a deterrent against moving—whether jobs are available or not. *Without a stable work force, a stable industry is seldom possible* especially at the wage-earner level. It is necessary that plants have well-trained employees; *otherwise companies become uncompetitive and mobile themselves.*

The public interest in private retirement plans is obvious—and many public figures have commented both pro and con on this. Recently, Representative Thomas B. Curtis (R., Missouri) in speaking before the House of Representatives, remarked:

"* * * Congress, to a large extent, has followed the obviously sound policy that the workers of this country should be encouraged to adequately provide for their superannuation beyond the basic floor provided by social security to the extent that each person feels is reasonably adequate for his particular circumstances, through a combination of personal thrift and investments, through insurance, and through private retirement programs. In 1942, Congress provided an impetus for private retirement plans by clarifying the tax treatment of such plans in the Internal Revenue Code. In the years following, business and labor responded with great initiative. Today well over 25 million people are covered under private pension plans, and estimates are that by 1980 total coverage will exceed 42 million employees. Equally important is the growth that private pension plans have experienced. In 1950 less than 10 million employees were covered in plans with some $12 billion in assets. Today, the assets of these plans are approaching $90 billion * * *."

Part Two—THE McCLUNG REPORT

A Critical View of Pensions

Recently, the value of private pensions has been the subject of much discussion—both in and out of the Government. Probably one of the most negative papers written on the subject is *Old Age Income Assurance: An Outline of Issues and Alternatives.* The document was prepared by the committee staff for the Subcommittee on Fiscal Policy of the Joint Economic Committee, Congress of the United States (Washington, U.S. Government Printing Office, 1966—Document No. 70-508 0). In her transmittal letter, Representative Martha W. Griffiths (Democrat, Michigan) said that the document was prepared primarily by Dr. Nelson McClung, a staff economist specializing in fiscal policy matters. The document has become popularly known as the McClung report.

The report caused a great deal of mental chafing in business, union, and Government circles because of its rather free-swinging denunciation of the *total* pension (and tax) system—both private and public (social security, municipal, State, and civil service pensions included). Dr. McClung gives the impression that no one is doing a good job.

In preference to answering Dr. McClung's charge on a paragraph by paragraph basis, this paper will address itself to the major issues

raised by the report. However, to understand Dr. McClung in full, his entire document should be read.

The following pages address themselves to major issues raised in the McClung report. These we believe to be in the areas of:

I. The purpose of private pensions and social security in our society.

II. The value of public support (through tax incentives) of private pension plans.

III. Tax "inequities."

IV. Private pensions, their administration, and their "unfair" provisions.

V. Pension plan funds and reinsurance.

VI. Suggested future approaches or "alternatives."

I. THE PURPOSE OF PRIVATE PENSIONS AND SOCIAL SECURITY IN OUR SOCIETY

Prior to 1935, the Nation had no public retirement program and few private retirement plans. As we have seen in part 1, the private pension segment has increased dramatically. The growth of social security is no less dramatic. In 1939, the maximum yearly primary benefit was $492 and the maximum tax was 2 percent (1 percent on the employer and 1 percent on the employee) on the first $3,000 of earnings. Today the maximum tax is 8.8 percent (4.4 percent each on the employer and employee) on a wage basis of $6,600 and the present maximum yearly primary benefit is $1,630.80.

Dr. McClung gives the impression that pensions are primarily social in nature. He is right to a certain degree. But pensions also have economic, business, and personal implications and characteristics. And perhaps in evaluating Dr. McClung's various remarks some discussion is necessary concerning the philosophy of pensions—both public and private.

Within this context, Dr. McClung makes these comments (interpreted and paraphrased):

1. Old age pension system satisfies public objectives very poorly.
2. The objectives of private plans are not in the public interest.
3. Distribution of burdens on young and benefits to aged are unfair.
4. The "merit versus needs" concept of benefit payments does not satisfy the public interest.

There are a number of other issues but these are among the most important. A brief discussion on each of these points follows:

1. *Old age pension system satisfies public objectives very poorly:* This is an extremely broad statement and completely unsubstantiated. As was pointed out in the *Editor's Note*, many of Dr. McClung's remarks were based on "assumptions." The truth in fact is that both private and public pensions are serving the public interest very well:

(a) Social security has been in existence for just 32 years and has provided millions of retirees and their dependents with billions of dollars in retirement benefits.

(b) There were about 750 qualified pension and deferred profit-sharing plans in 1940—the year that private plans began to grow; today there are well over 132,000 qualified plans; these plans have also provided millions of retired employees with billions of dollars in retirement benefits.

While cold statistics are no proof of how well or how badly pension plans meet public objectives, they are an indication of the relative merit of pensions to the public. Part 1 has shown that one of 10 Americans now receive social security benefits and that 2.7 million persons received $2.9 billion in private pension benefits in 1966 alone. On the basis of logic alone, these figures indicate the relative merit—if in monetary sums alone—of private and public pensions to the society.

These retirees are, after all, a part of the public.

Private pension plans are a very young institution as indicated by the above figures. Many private plan critics ignore this youth. Of the 132,000 qualified plans in existence today, over 131,000 did not exist 25 years ago when the Internal Revenue Code of 1942 was passed giving tax inducement to establish plans. We can make many assumptions about the future of private pension plans. If today's figures are an indication of tomorrow's private pension value, we can make a more valid assumption of private pensions' success in satisfying public objectives.

We might also point out to Dr. McClung that one of the original objectives of the 74th Congress in enacting social security was to provide an economic floor for retirees after age 65. In revising the Internal Revenue Code in 1942, Congress gave industry a significant inducement to set up private pension plans for economic, business, and social purposes. The personal aspects of pensions are multifold. Under our present form of taxation, thriftiness is practically discouraged. Income taxes, real estate taxes, State income taxes, excise taxes, amusement taxes, sales taxes, and a bevy of indirect taxes of all types make saving for retirement difficult, if not impossible. Without social security and private pension plans to help retirees maintain an adequate standard of living (based on their pre-retirement standard), many retirees would have become charity cases. (It should also be pointed out that social security payments are a tax paid *jointly by the employer and employee*, and should not be considered some form of Government subsidy given to the public.)

These personal aspects of pensions are undoubtedly social in nature and serve public objectives.

2. *The objectives of private plans are not in the public interest.*—Much of this paper refutes this point. A comment by Dr. Carl Fisher before a meeting of the American Pension Conference (New Yorker Hotel, New York, N.Y., February 9, 1967) might add another note to this discussion:

"Now we come to another argument. There is the 'question about the wisdom of entrusting to private organizations the management of a collective income transfer system.' The reference is to (private) pensions. So now, the proposal appears to be that something which originated in private industry, grew under private industry, should be turned over to * * * the Government.

"Talking about collective *income transfer* system, what about the collective income system? It is even more important than the transfer system, and certainly consumers and taxpayers are interested in that, too. Interest too important to be entrusted to private organizations? This reminds me of what the first Queen Elizabeth was reputed to

have said about sex: 'It's much too good to be permitted to the common people.' "

Dr. McClung's thesis seems to ignore the fact that private plan beneficiaries *are the public*. Congressmen elected by the *public* and representing the *public* have initiated the tax policy covering private pension plans in response to the *public's* desire to see private pension plans expand and grow.

3. *Distribution of burdens on young and benefits to aged are unfair.*—The first portion of the statement is undoubtedly true and has been a matter of public policy since the original social security bill was enacted. It was, however, the fairest of many alternates open to the 74th Congress and a responsibility that the public and industry undertook as a whole when social security was enacted. A popularized version of this public policy can be culled from various paragraphs in Schlesinger's *The Coming of the New Deal:*

"* * * In the meantime, corresponding progress was being made toward provision for the aged. Here there was a long tradition of national concern. The Progressive platform of 1912 had called for old-age pensions, and in the years following a number of States investigated the possibility of pension laws. In the twenties, eight States passed optional laws, and with the depression there was a great swing to mandatory legislation. In 1933 alone, 10 states passed mandatory acts. *Yet in all these laws payments were based on need;* coverage varied tremendously; and nearly half the States had no laws at all. To Epstein and his Association for Old-Age Security, as well as to many others, there seemed a pressing need for Federal action * * *.

"* * * On June 8, 1934, therefore, he (Roosevelt) sent a message to Congress, vigorously affirming his faith in social insurance ('among our objectives I place the security of the men, women, and children of the Nation first') but suggesting that legislation be deferred until the next winter. At the same time, he laid down what he regarded as the principles of a sound program: It should be a State-Federal program *actuarially sound*, and financed by contributions rather than by an increase in general taxation. Three weeks later he appointed a cabinet Committee on Economic Security, with Frances Perkins as chairman, charged with formulating a program to be submitted to the President before December * * *. (Our emphasis.)

"* * * When the Committee on Economic Security came to the question of the aged, it adopted a national system of contributory old-age and survivors insurance without anxiety or fuss. In so doing, it took a venturesome step which contrasted strikingly with the caution shown in the case of unemployment compensation—and in spite of the fact that much more thought had been given to a national system for the unemployed than for the aged. One reason why the committee could be more audacious here was the absence of State old-age insurance projects; there was no Wisconsin plan to create vested intellectual interests. Another was the fierce outside agitation for old-age pensions; though the Committee on Economic Security had started work before Dr. Townsend's plan for $200 a month for everyone over 60 had developed momentum, yet the mounting Townsendite clamor in late 1934 and early 1935 certainly improved the opportunity for inserting

sweeping old-age insurance recommendations in the social security bill. *Another—and perhaps decisive—reason was the conviction of the actuaries that old-age insurance on a State basis would be infeasible because of the great mobility of workers in the course of a lifetime* * * *. (Our emphasis.)

"* * * On January 15, 1935, the Committee on Economic Security transmitted its reports to the President. Roosevelt already had his own views on social security. 'There is no reason why everybody in the United States should not be covered,' he once said to Miss Perkins. 'I see no reason why every child, from the day he is born, shouldn't be a member of the social security system * * * I don't see why not. Cradle to the grave—from the cradle to the grave they ought to be in a social insurance system.' "

"*He* (*Roosevelt*) *had in addition specific views about the character of a social insurance program. Thus, he believed that public insurance should be built upon the same principles as private insurance. 'If I have anything to say about it,' he once remarked, 'it will always be contributed, and I prefer it to be contributed, both on the part of the employer and the employee, on a sound actuarial basis. It means no money out of the Treasury.' This meant a self-supporting system financed by contributions and special taxes rather than out of the general tax revenue. Frances Perkins, arguing against employee contributions, pointed out that the employer shifted the payroll tax to the consumer in any case, so that employees were already paying their share; Tugwell, arguing against the payroll tax, pointed out that this amounted to a form of sales tax and meant that the system would be financed by those who could least afford it; but none of this argument availed. 'I guess you're right on the economics,' Roosevelt explained to another complainant some years later, 'but those taxes were never a problem of economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions and their unemployment benefits* * * *.' (Our emphasis.)

" * * * The Committee on Economic Security, confronting the problem of the aged, proposed a compulsory system of contributory payments by which workers could build up gradually their rights to annuities in their old age. This left the problem of persons on the verge of retirement who had no past opportunity to contribute to their own old-age pensions. The best way in which these aging workers could be taken care of, the committee concluded, was through the Federal Government's paying a share of the cost. By 1980, according to its estimate, the Government would have to contribute to the old-age system around $1.4 billion a year. The committee conceded that the creation of this commitment would impose a burden on future generations. But the alternative would be to increase reserves at a far higher rate and thus impose a double burden on the present generation, which would have to contribute not only to its own annuities but to the unearned annuities of people middle-aged or over. '*The plan we advocate,*' *said the committee*, '*amounts to having each generation pay for the support of the people then living who are old.* (Our emphasis.)

"Morgenthau had accepted the committee plan and signed the report. Yet as he meditated the financing scheme, he began to feel a

certain immorality, as he told the Ways and Means Committee, in the notion of 'borrowing from the future to pay the costs.' Roosevelt shared Morgenthau's disapproval. 'It is almost dishonest,' he told Frances Perkins, 'to build up an accumulated deficit for the Congress of the United States to meet in 1980. We can't do that. We can't sell the United States short in 1980 any more than in 1935.'

"The Treasury alternative was to raise the rates of contribution and thereby build a much larger reserve fund, so that future needs could be met from the fund rather than by levies on current general revenue. This fund, Morgenthau suggested, could be applied to the reduction of the national debt. Roosevelt even supposed that it might eventually serve as the sole customer for Federal bonds, thus freeing the Government from reliance on private bankers. Under the original plan, the maximum size of the reserve fund would have been less than $12 billion; under the Treasury plan, it would amount to $50 billion by 1980. The Treasury plan had obvious disadvantages. It shifted the burden of providing for currently aging workers from the population as a whole to the younger wage earners. 'Our programs,' said Abraham Epstein, 'actually relieve the wealthy from their traditional obligation under the ancient poor laws.' Moreover, the creation of so large a fund involved economic risks. As Alvin Hansen on the Technical Board, and Marion Folsom of the Eastman Kodak Co., on the Advisery Council pointed out, it would divert a large amount of money from consumer purchasing power; 'that is bound,' Folsom said, 'to have a depressing effect on general conditions.' And the problem of finding ways to invest $50 billion seemed packed with difficulties.

"The self-sustaining theory of social insurance meant, in effect, that the poor had to pay most of the cost of keeping the poor. Yet, whether because of this or in spite of this, the House committee quickly adopted the reserve system; probably the idea that private insurance should serve as the model was too compelling. Moreover, there was the political advantage which so impressed Roosevelt. Under the original plan, the old-age insurance system would be at the mercy of each succeeding Congress; while, with a vast reserve fund built up out of contributions, the people were in a sense creating a clear and present equity in their own retirement benefits. The existence of the reserve thus undoubtedly strengthened the system politically. Yet the impact of the reserve on the business cycle—the withdrawal of large sums of money from the spending stream and the reliance on regressive taxation—doubtless added deflationary tendencies which later in the decade weakened the whole Nation economically. In time, it appeared that the administration and the Congress had made the wrong decision in 1935 * * *.

"* * * The Social Security Act in its final form was far from a perfect piece of legislation * * *.

"* * * For all the defects of the act, it still meant a tremendous break with the inhibitions of the past. The Federal Government was at last charged with the obligation to provide its citizens a measure of protection from the hazards and vicissitudes of life * * *."[10]

Human institutions are, of course, imperfect establishments, but in the case of social security what was the alternate to a present young

[10] Arthur M. Schlesinger, Jr., *The Coming of the New Deal* (Boston: *Houghton Mifflin* Co., 1959), pp. 303–315.

generation accepting responsibility for a present old generation? Dr. McClung offers no acceptable alternatives. And perhaps none is available unless we accept a monolithic government which completely changes our democratic institutions. *This is perhaps one of the paradoxes in the McClung thesis: a complaint that the young take care of the old (which shows a population's social commitment) while complaining that private pension plans establish reserves so that the young will provide benefits for themselves.*

4. *The "merit versus needs" concept of benefit payments does not satisfy the public interest.* This point attacks some of the basic fundamentals of our society.

(a) An employee has a right to better his work conditions, including compensation and all the inherent manifestations of those conditions (e.g.: wage-related pensions as a manifestation of "merit").

(b) An employer has the right to set the conditions of employment and the benefits which accrue from that employment; these may be set unilaterally, but such conditions as collective bargaining and competitive "facts of life" often modify this unilateral right.

(c) The free enterprise system has risktaking as one of its most prominent features; this is exemplified by the birth, growth, or death of companies; it is also an inherent part of the employee's right to remain or sever (*risktaking*) his employment with a company in order to expand his future opportunities.

(d) The motivation of employees in the United States is a complex phenomenon—but the recognition of "merit" and its attainment is undoubtedly one of the pillars upon which this nation has been built—*and one of the manifestations of merit includes the building of pension benefits.*

The above arguments are not meant to disregard the "needs" aspects of funds after retirement; they are put forth to show the "needs" aspects of "merit." (Most private pension plans give the "needs" aspects of retirement high priority. "Final pay" or "minimum benefit" retirement plans are examples of this acute interest—and responsibility—on the part of management.) If we are to increase an employee's total contribution "to society," the destruction of the merit principle will be extremely harmful to our society—as shown by worker "interest" in Communist societies and by worker "motivation" in such "paternalistic" countries as Uruguay.

II. THE VALUE OF PUBLIC SUPPORT (THROUGH TAX INCENTIVES) OF PRIVATE PENSION PLANS

III. TAX "INEQUITIES"

Dr. McClung's entire thesis (as that of other pension plan critics such as Representative Griffiths, Prof. M. C. Bernstein and others) rests on the value of public support (through tax incentives) of private pension plans. As outlined in part 1, pages 6–8, of this paper equitable tax treatment has been given to employers to establish pension plans. Briefly these advantages are discussed on pages 11–12 of

part 1. The following discussion in the form of questions and answers reviews some of the important points in this "problem":

Q. Why has the tax policy given an inducement to employers to establish pension plans?

A. There were obviously some political reasons why tax incentives were given, but there were also some very good economic and social reasons. This "delegation of social responsibility" is attacked by Dr. McClung. This attack, however, fails to recognize that private companies and their managers *are capable* of social responsibility and commitment. If private plans are not permitted to expand, there is one obvious outcome: The necessity of increased Government intervention to supply pensions to the public through social security, public assistance or other *tax-supported* schemes. And this leads to the question of how much more this will cost in increased taxation as compared to the "supposed loss" of $1 billion.

Q. Have public pensions made any contributions to public good?

A. This question can be answered in a series of statements:

(a) In 1966, about 2.7 million retired workers received an estimated $2.9 billion in private retirement benefits.

(b) Older plans that were initiated *long before* the supposed "tax subsidization" of 1942 have continued to expand their plans and supply retirement benefits to their employees (e.g.: Eastman Kodak, Union Carbide, A.T. & T., etc.)

(c) Pensions funds—far from being stagnant reservoirs of wealth—have supplied funds for growing businesses, mortgages, *and* Government needs.

Q. Does the public pay the cost of private pensions plans?

A. It is impossible to ignore Representative Griffiths' charge as quoted on page 96 in part 1 of this paper that the general public pays a large part of the cost of private pensions. In arguing with the critics, this question must be faced squarely. Yes, the public does pay a large part of private pensions (just as it pays the employees' wages for which it receives a product); it is justified; it is a part of every economic system known to man. The basic principle of establishing prices for the marketing of goods or services requires that projected production, distribution, compensation, etc., costs be determined. Predicted pension funding costs are very often a part of this process. (With the initiation of accounting opinion No. 8, this cost now becomes—more or less—a definitely predictable accrual cost to be charged against income.) The cost of the product therefore must include the cost of pensions. However, the favorable tax policy relieves the consumer of paying at least a portion of this cost.

Q. But doesn't the public then pay for this "saving" by increased taxes as Representative Griffiths points out?

A. This is also a question which Dr. McClung brings up in his "forward shifting" concept on pages 9–10 in the report. This point may be discussed within the following context:

(a) If we assume that the "unsubsidized" portion of an employer's cost for pensions is in the price of his product we can also readily assume it is a part of doing business and that in a competitive market it will affect whether the product is purchased or refused by buyers.

(b) We can further assume that if the product is not competitive because of quality, need or cost, the employer must make adjustments of some sort to again make the product competitive *or* go out of business.

(c) The employer's portion of pension costs is therefore an important part of his product's cost which cannot easily be passed on to the consumer.

(d) The employer, however, does receive some tax incentive in providing pension benefits by having a qualified pension plan; he is permitted to put sums of money away to provide retirement benefits for present and future retirees (the public?).

(e) We can assume then that a present generation of workers are providing for their future benefits by a present employer's contributions to pensions (as opposed to the social security pay-as-you-go concept where today's employees are paying for today's retirees' benefits).

These assumptions are, of course, only one method of evaluating the charge of "forward shifting." One concept is, however, often overlooked. Too often the questions of the value of private pensions and their taxation are only evaluated in the context of the present. Yet, the very nature of pensions is to provide future solutions to the problems of employee retirement and standards of living. Undoubtedly, one of the *long-range* objectives of private plans is to have ample funds readily available when employees retire. And perhaps, this was one of the *long-range* objectives of Congress in formulating tax policy in 1942. If these *long-range* objectives are being met, we believe they are in the public interest.

While we hesitate to enter into the field of economics with its various theories and jargon, it is worth noting Dr. McClung's document has a large rip tide of economic theory. Undoubtedly the concept of "laissez-faire" is largely dead, having received a mortal blow since 1932. Keynesian economics of a government-planned economy have been with us since that time. And the "new economics" of the Kennedy era continues the massive government involvement in fiscal policy. If "tax inequities" do exist in pension-related areas, they are just one small part of our entire tax structure problem. Perhaps this point can best be summed up by another "critic." Louis Rolnick, Director, Welfare and Health Benefits, International Ladies Garment Workers, in speaking on the President's Committee Report (20th Annual Conference on Labor, New York University, April 20, 1967) remarked on the question of private pension tax relief:

"It is undeniable that this tax treatment constitutes an indirect public subsidy to the plans. I find this, however, to be the least persuasive of the considerations cited as justifying additional regulations. The report relies heavily for its recommendation on vesting on the theory that equity requires identification of employer payments as a kind of deferred wage. If we adopt this premise, it follows that such payments are normal production costs and should not be taxable in any event. Estimates of annual revenue losses range from $1.2 billion to $3.4 billion. I am sure that these figures stack up favorably against a whole host of tax involved public subsidies for institutional schemes which are far less easily identified as being in the public interest."

As a final comment, we might point out that many features of Dr. McClung's "tax policy" are *regressive*. In part 1, pages 6–8, we noted the progressive tax policy which was initiated concerning pension plans. Dr. McClung's recommendations would do away with all of these advances and take us back to the tax policies of 1910–1920's. (This might be considered favorable if we are also permitted to pursue some of the personal income tax policies of the period.)

IV. PRIVATE PENSIONS, THEIR ADMINISTRATION AND THEIR "UNFAIR" PROVISIONS

These points can be answered in a series of statements:

Plan administration: The report suggests that the public might be better served if all plans were joined and administered by a public agency. (Similar proposals have been made by other public documents including S. 1103—the Javits bill—and the President's Committee Report.) This, of course, suggests another Government intrusion into the affairs of private business. We can assume that if such a "pension clearing house" is established, it will be the first step toward the eventual control and regulation of pension fund investments or establishment of reinsurance—and probably the elimination of funding altogether.

Another aspect of the plan administration which Dr. McClung discusses can best be answered by Dr. Fischer again:

"The next topic concerns the administrative decisions which 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. It is contended that 'plans are rarely so simple and the affairs of individuals so uncomplicated that there is not room, indeed a necessity for plan officials to exercise discretion,' and this discretion may be exercised in ways which in effect constitute a system of rewards and punishments.

"Well, let's see how tough these decisions are. Here is John Jones. He's had 30 years with the company, as the record shows. The plan states that he gets $4.25 per month for each year of service. What's so complicated about that? You have to notify the trustee or the insurance company that Jones gets $127.50 a month for life. How can you punish Jones? Who makes what complicated decisions? How does the administrator reward anybody? . . ."

Vesting: The matter of vesting is, of course, one of the major problems of pensions as we know them today. Dr. McClung and other public figures would prefer either total or partial early vesting. There is no unanimity of opinion on vesting:

(a) Dr. McClung suggests full and immediate vesting after a short probation period.

(b) The President's Committee Report suggests a possible vesting standard: 50 percent vesting after 15 years of service, increasing at the rate of 10 percent a year to full vesting after 20 years of service.

(c) Senator Javit's bill (S. 1103) suggests full vesting after 15 years of service and age 45, or, alternatively, a 50 percent vested right after 10 years and full entitlement after 20 years.

(d) Representative J. D. Dingell's bill (H.R. 4462) requires vesting after 10 years of service.

While public officials are arguing about the "appropriate" period of vesting, industry is itself solving the problem of vesting through plan design, competitive pressures and collective bargaining. Trends indicate that vesting is becoming much more liberal in many plans as automation and labor mobility increase in our society.

We also believe that this right to determine vesting should remain within the private domain. Vesting, after all, requires money—and the employer and employee should determine how this money should be spent.

V. PENSION PLAN FUNDS AND REINSURANCE

In discussing pension plan funds and reinsurance, Dr. McClung brings up these major points:

(a) Maintaining an adequate fund is equivalent to the assumption that the plan might terminate at any time.

(b) Pension funds induce an excessive rate of saving and hinder a productive deployment of wealth.

(c) Pension fund saving can be reduced substantially by reinsurance (not of the employer but of pension promises).

These points are interesting challenges to logic and to economic points of view. In the first point we are to assume that Dr. McClung challenges the concept of having funds on hand to meet emergencies or unforseen events.

Referring back to Dr. Fisher's paper, he says:

"We are told that pension plans save in order to provide for the contingency that contributions will diminish or cease. There is much more to pension funding than that. For example, the funding concept provides a suitable measure of incidence of cost of the plan even if the money is not paid in. That is of importance in cost accounting and the pricing of a product. If the liabilities are actually funded, this merely means the employer has paid the part of his wage cost represented by pensions as well as having paid the rest of his wage cost. If he doesn't fund, he is deferring the payment of the cost until retirement of his employees, and thus shifting it to another generation of workers and customers.

"Another reason for funding is that in the event of termination of the plan, its liability accrued to that date can be met. We are told that some plans have no need of funding, presumably because the sponsors cannot go out of business. But who is going to select those? Because how many of these immune firms are there? At the turn of the century the railroads seemed among our most solid institutions. A little later Packard and Studebaker were among the proudest names of the automobile industry. What happened to them? What does it mean to say, as the paper does, that 'those plans most in need of conservative funding have sponsors who can least afford it'—well, if they can't afford funding, they can't afford pensions."

(We wonder what would have happened in ancient Egypt if the Pharaoh had a similar economic point of view as Dr. McClung's when Joseph recommended saving in the 7 prosperous years.)

In Dr. McClung's second point, he again challenges the concept of saving. This argument is again a reflection of the "new economics" where government spending is desirable even in a period of economic

boom. As was pointed out previously, pension funds flow into the economy.

The concept of minimum or no funding and reinsurance requires some analysis. One of the most comprehensive evaluations of the reinsurance concept was given by P. C. Bassett when he appeared before the Senate Committee on Finance hearing (Washington, D.C., Aug. 15, 1966) to give testimony on Senator Vance Hartke's Senate bill 1575 on reinsurance. While Dr. McClung's reinsurance suggestions differ somewhat from Senator Hartke's, the concept remains the same. Mr. Bassett said:

"The purpose of insurance is to spread a risk over a large group in order to protect individual participants against the loss resulting from some uncontrolled event. The cost of the insurance to be equitable should be borne by the participants in proportion to their exposure to the hazards insured against. As presently written, S. 1575 fails in a number of areas to meet these requirements.

(1) In this situation, the risk insured (pension benefits) against is not beyond the control of the insured. The insured determines, to a large extent, whether or not a certain facility or business operation will go out of existence. An analogy would be to issue fire insurance on a home and agree to pay the owner for the loss if he has the right to burn the home down. The risk insured against in S. 1575 is largely within the control of the purchaser.

(2) *Such a program, I believe, may encourage minimum funding by employers, since the security of pensions will no longer be a compelling reason for funding. It may be cheaper to pay the "premium" than to fund adequately the pension plan, thus stimulating the wrong kind of pension planning.* (Our emphasis.)

(3) As stated above, the cost of the insurance should be borne by the participants in proportion to the risk involved. Under the proposal, the cost of the insurance is to be a function of the unfunded cost of the benefit expectations. This is only one small factor in the measure of the risk. The risk also involves the probability of discontinuing the plan for business reasons. For example, three companies: a utility company in a metropolitan area, a manufacturer of hoola hoops and skate boards, and a large subcontractor supplying a very special item necessary for the operation in Vietnam might have the same unfunded pension cost. It is evident the risk of each of these enterprises going out of business is radically different, the probability of which would be difficult to determine. But certainly, some of them would be more likely to require the insured benefits than another. Yet, the proposed Bill would charge each company the same premium. (*Dr. McClung does not advance this theory.*) Thus, the reinsurance program would seriously discriminate against pension plans established by stable organizations which are likely to continue in existence for many years. The program would operate against our oldest and soundest corporations in favor of companies which may overreach themselves in assuming pension obligations, and other companies which do not expect to exist except for a relatively short time.

(4) The problem of measuring the risk also applies to the second part of the insurance proposal—namely, covering losses on the liquidation of assets. In order to properly assess the premium it is necessary to determine some measure of the risk involved in different investments made by the pension fund. I do not believe that it is possible to insure that the stock market will not go down in future years or that poor investments will not be made by pension trustees.

(5) *If a reinsurance program were undertaken, I believe the Government would quickly find itself in the business of establishing a wide variety of investment standards, payment standards, funding standards and other criteria for pension plans which would result in placing all such programs under a governmental strait jacket and thus depriving these plans of the inherent flexibility which, I believe, lies at the root of their success and value.*" (Our emphasis.)

VI. SUGGESTED FUTURE APPROACHES OR "ALTERNATES"

There are many suggestions which Dr. McClung makes including:

(a) Removing the wage taxation ceiling on social security.

(b) Taxing fund contributions on investment return.

(c) Vesting employees, make them contribute to pension plans, and tax employees for employer contributions.

(d) Fund private pensions at a low level and reinsure pension promises.

(e) Regulate pension funds even more than they are today and require more disclosure.

(f) Initiate a pension clearinghouse.

There are a number of other suggestions in Dr. McClung's Report. Industry on its side might counter with suggestions:

(a) That employee contributions be made tax deductible.

(b) For the adoption of a master plan and/or trust concept for small employers similar to the present H.R. 10 method.

(c) That greater tax incentives be granted to encourage private plan adoption.

(d) That encouragement be given to more rapid funding.

Undoubtedly, there are many questions left unanswered. Dr. McClung admits to having made his charges on "assumptions." More study is therefore needed. While Mr. Bassett's remarks before the Senate Finance Committee were in answer to Senator Hartke's reinsurance bill, his comments show the value of study needed in this entire area:

"In my judgment, the true strength and unique value of private pension and profit-sharing plans lie in this inherent flexibility—in their ability to meet the requirements and the capabilities of widely varying corporate situations, and to adjust to new experiences and new situations. I believe that the government should be extremely cautious in trying to impose on these plans mandatory standards of a type which will tend to deprive them of this important flexibility—standards which would tend to convert the private retirement system into something akin to social security.

"This is not to say that there may not be a need for further legislation or regulation. Improvements can and should be made in the

statutes and in regulations; and in my judgment, companies with experience in this field are quite willing to work with the government toward the development of such improvements where the need is demonstrated and where the benefits of such changes clearly outweigh the difficulties. It is my conviction, however, that some of the alleged weaknesses in present statutes and regulations have been overstated and that isolated examples of deficiencies have been cited as justification for sweeping new statutes and regulations affecting all plans—the overwhelming majority of which are soundly conceived and soundly administered * * *.

"* * * In this regard, I understand from the testimony of the Secretary of Labor Wirtz before the Subcommittee on Fiscal Policy of the Joint Economic Committee that a joint study is now under way by the Bureau of Labor Statistics and the Internal Revenue Service of 7,000 pension plans that were terminated between 1953 and 1965. The purpose of this study is to ascertain the reasons why these plans were terminated. It may also be possible to find out what effect these terminations had upon the employees * * *.

"* * * But, as I have mentioned, it is my conviction that these objectives are being achieved to an increasing extent through voluntary improvement of retirement programs and that further improvement will come through the years.

"Here again, while this is my belief, facts will be available in regard to the extent of funding in private pension plans. The pension research council under the auspices of the Wharton School of Finance and Commerce at the University of Pennsylvania is making an exhaustive study of funding in 5,000 private pension plans. Consulting firms and insurance companies are participating in furnishing data. This study is being financed by the Social Security Administration, private foundations and by private sources. The study will probably cost in excess of a half million dollars. It holds promise of providing a definitive clue as to whether there is any necessity for further governmental action in the funding area. I am convinced that this study, as well as other studies now being conducted by the government and by private sources, will lead to a better understanding of precisely which aspects of private retirement programs may be deficient, and which aspects could be benefited by new statutes and regulations * * *.

"* * * Earlier, I mentioned the studies going on by the pension research council and the joint study by the Bureau of Labor Statistics and Internal Revenue Service. I understand that the SEC is making a study examining the financial data of trusteed pension plans. In addition to its regular annual report, it is stepping up its studies to include both book and market values of assets, and the purchase and sales of common stocks. I believe it intends to issue quarterly reports on transactions in these funds. Perhaps this information will be of additional value and give more facts on which to determine the appropriateness of any legislation.

"Until these studies are completed, Mr. Chairman, and until substantial consideration and evaluation have been given to them, I would urge the Congress not to take action on legislation such as S. 1575. Private retirement programs adopted by corporations for the benefit of their employees constitute a unique and constructive American development which, on the whole, is serving the Nation extremely well.

In light of the long-range nature of these programs, and their past success, the Government has an obligation to move deliberately and cautiously in changing the ground rules under which they operate. Certainly, to date there has been no clear demonstration either of the need for or constructive results that would result from a program of Federal reinsurance for unfunded pension benefits."

And finally, the comments of Frank M. Kleiler, Director, Office of Labor-Management and Welfare-Pension Reports, U.S. Department of Labor, might be appropriate with which to complete this discussion. Mr. Kleiler was speaking before the 20th Annual Conference of Labor at New York University. His comments were related to—what he considered—necessary pension legislation. His comments are worth noting:

"Private pension plans should continue as a major element in the Nation's total retirement security program, although the public program (the Federal Old-Age Survivors and Disability Insurance system) will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows and dependents. *Public policy should continue to provide appropriate incentives to private plans, and by improving the basic soundness and equitable character of such plans, set a firmer foundation for their future development.*" (Our emphasis.)

AMERICAN FARM BUREAU FEDERATION

BY ROGER FLEMING*

We appreciate the opportunity to submit comments for the Fiscal Policy Subcommittee's compendium on old age income assurance.

Our official policy resolutions on this subject are limited to brief statements on Social Security and on Self-Employed Retirement Plans, which read as follows:

Social Security

Social security programs should be designed to supplement rather than replace individual thrift and personal responsibility.

Any increase in social security benefits should be limited to those which can be financed without an increase in taxes or the use of general tax revenue.

A retiree's social security benefits should not be reduced because of his current earnings.

Small employers should be permitted to pay social security taxes on an annual basis.

The financing of the social security program by payroll taxes disguises the cost of the benefits and lulls the taxpayer into a false sense of well being. We support a method of tax collection which will require people to pay their share directly rather than through withholding by their employers.

In fairness to young workers, the social security taxes paid by individuals—but not those paid by employers—should be graduated on the basis of age.

Self-Employed Retirement Plans

We strongly support the Self-Employed Individuals Tax Retirement Act as amended in 1966.

This act permits farmers and other self-employed persons a limited deduction for payments to an approved retirement plan, in recognition of the benefits long available to many employees under employer-sponsored retirement plans.

Both of these resolutions reflect our belief in the importance of "individual thrift and personal responsibility" in the solution of old age income problems; however, these words should be broadly construed to include retirement plans developed by employers either independently or through collective bargaining with employee representatives. Farm Bureau has a retirement program for its own employees which is available to affiliated organizations. It also has developed a retirement plan for Farm Bureau members under the Self-Employed Individuals Tax Retirement Act.

In our opinion, it should be the policy of the Government to encourage the development of private methods of meeting the needs for

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old age income assurance rather than to continue to increase taxes and benefits under the social security program.

The present social security program places a heavy penalty on the earning of supplemental income by benefit recipients. It also penalizes youthful taxpayers who could buy more protection in the form of private annuities for the amount of the taxes now being paid on their earnings. To correct these inequities, our policy resolutions recommend that retirees be permitted to earn current income without a reduction in social security benefits and that the social security taxes paid by individuals be graduated on the basis of age, somewhat as the premiums are graduated for several common types of private insurance policies.

Elimination of the present ceiling on the earnings of social security beneficiaries would remove an undesirable penalty on productive effort, and place retirees who depend on labor for supplemental income on the same basis as those who receive such income from sources other than current labor.

A system which increased the amount an individual is required to contribute toward the purchase of social security benefits as he approaches retirement would distribute the cost of the program far more equitably than the present system by eliminating, or at least reducing, the present discrimination against young workers. In our opinion the greater equity to be achieved through a graduated tax system would make it acceptable to older, as well as young, taxpayers.

PRIVATE PENSION PLANS IN THE UNITED STATES

BY JAMES F. OATES, JR.*

In response to an invitation from the Subcommittee on Fiscal Policy of the Joint Economic Committee of the United States Congress, the Equitable submits this statement of its position on the private pension system in the United States and on related issues of major importance discussed in a joint committee print prepared by the committee staff.[1] The Equitable has participated actively in the private pension movement from its beginnings, and now manages almost $5 billion accumulated under several thousand private pension plans on behalf of over a million persons.

STRENGTHS OF THE PRESENT PUBLIC-PRIVATE SYSTEM

1. In the Equitable's view, the single most important advantage of the present mixed system of public (social security) and private pensions is that it distinguishes properly between minimum needs in old age, which the community should assure, and the replacement of income (or any other individual objectives for old age), which can and should be left to individual initiative and to collective but private bargainings.

It is now well established that as long as society encourages individual or collective bargaining with private employers, retirement income is a proper part of that bargaining. The logic of increased governmental responsibility for retirement income beyond minimum needs implies far more regulation of wages and salaries than the country apparently now deems proper.

The committee print states correctly that "a needs-related program in some form for the aged commends general acceptance," but adds 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" (p. 27). The print does not conclude what general principle to follow in a public program that would go beyond minimum needs. The presence of a thriving private pension system, however, avoids the need for public benefits beyond minimum needs and therefore avoids the need to answer a question the community has obviously not wished to decide collectively. Once larger public benefits are undertaken, however, there is an obvious danger that they could no longer be supported only by employer-employee contributions, which has been a valuable discipline in every past liberalization of social security. With the support of general revenues at hand, adequate control of public pensions would be in doubt. The

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[1] "Old Age Income Assurance: An Outline of Issues and Alternatives," Joint Economic Committee, Congress of the United States, U.S. Government Printing Office, Washington, 1966.

issue of what the working population owes the old would be confronted in far more acute form than it has been so far, and the result might well be ambitious benefit schemes the country is not prepared to finance in any noninflationary form.

2. The second major advantage of the present system is its contribution to the strength of the capital market through its development and deployment of substantial capital through decentralized saving and investment decisions.

Fundamental issues would be raised if the power to decide on the amount and form of investment of aggregate old-age saving of the half of the working population now covered by private pension plans were to be united in a single hand. Further, the management of these private pension funds by banks, life insurance companies, and other professional investment institutions has brought sophisticated and informed judgments to bear on the selection of competitive investment opportunities over the whole spectrum of possible capital employment.

Private pension funds now aggregate over $100 billion, and yet current events are a fresh reminder, if one is needed, that private investable capital is not in oversupply. It is highly probable that the spread of private pension plans has effected a net increase in aggregate saving. The committee print, in effect, grants this, but considers that this accentuates the dangers of unemployment. Taking a longer run point of view, however, it is almost universally agreed that proper fiscal and monetary policies can maintain approximately full employment. This will not be an easy task since we are on the threshold of a staggering increase in our labor force, and we are faced with the challenge somehow to create the jobs needed to employ this surging tide of manpower. To attain the employment objective will require a huge increase in capital investment, if along with the jobs we are also to have an accelerated growth of productivity and a more rapid advance in the level of living. Under these conditions, the argument in favor of stimulating saving and thus investment is decisive.

The only point that then remains at issue is whether this saving should be encouraged primarily in the private sector, or whether public-sector saving should be substituted. If insufficiencies of voluntary individual and collective private savings should endanger the growth of investment and productivity, Government would have to play a larger role in supplying investment funds to the private sector, or else do more of the investment itself. The committee print appears to support this larger role for Government. We do not believe it to be either necessary or wise. We prefer private sector activity wherever practicable and reasonable, and consider the encouragement to savings provided in the present system of private pension plans a distinct advantage that should not be abandoned.

Proposals for Private Pension Regulation

1. The committee print is in general opposed to *funding*. We believe that funding is desirable and to be encouraged. Benefit disbursements are generally at a relatively low level in the early years of a pension plan but rise gradually toward ultimate stability at substantially higher levels as the pension roll matures over many years. Funding, which is contributing to the plan in these maturing years more than required for current disbursements, has major advantages:

(a) It produces a more level and hence more manageable incidence of contributions. It replaces an initially lower but rigidly rising scale of contributions with a flexiblity of choice in direct proportion to the extent of prefunding.

(b) It develops a fund that supports benefit payments by investment earnings, which significantly reduces the plan contributions required thereafter.

(c) It accords with the concept of accounting for pension plan costs as they accrue rather than as they mature. This principle is now part of the body of generally accepted accounting principles set forth by the Accounting Principles Board of the American Institute of Certified Public Accountants.

(d) In the relatively infrequent occurrence of plan termination, it provides the means for meeting part of all of the pension expectations created by the plan.

Mandatory funding requirements, which some advocate, have important disadvantages, however:

(a) Nothing is gained with respect to employers that would have met the legislated requirements in any event. As to those who would not, the result of driving some employers to greater funding must be weighed against the result of causing others to reduce benefits or terminate plans.

(b) Inflexible standards for measuring pension plan costs can produce estimates quite inappropriate for the individual plan in the light of its particular mortality, investment, turnover, and other experience. Companion standards for measuring the values of plan assets can have the effect of restricting investment flexibility, to the detriment of the plan and the employees who are to be safeguarded.

If particular funding levels are, nevertheless, to be mandatory, it is clearly preferable to develop objective, legislated standards than to rely upon continuing administrative supervision. Requirements should be moderate in terms, perhaps directed to benefits for which vesting (see item 2, below) has been similarly mandated; they should apply prospectively, with reasonable recognition for problems of transition; and perhaps some exemption or tolerance could be afforded for the special circumstances that may arise in collectively bargained arrangements.

2. The Equitable agrees with the committee print that reasonable *vesting provisions* in pension plans are desirable and should be encouraged. As pensions come to be regarded more and more as an aspect of compensation rather than as a benefit unilaterally accorded by employers, lack of vesting will increasingly appear unfair and arbitrary. However, vesting is costly, and burdensome requirements may discourage employers, particularly small employers, from establishing pension plans. Accordingly, as with funding, we believe that any legislated requirement should be moderate in terms and apply prospectively, with provision for transition and perhaps for collectively bargained agreements. The requirements proposed by the President's Committee (50 percent after 15 years, full vesting after 20 years) seem moderate if applied to future service benefits.

3. *Disclosure* of the status of pension vesting and funding is desirable, not only as an alternative to the requirements discussed in para-

graphs 1 and 2 above, but as an end in itself. It will require considerable ingenuity, however, to develop mandatory standards that will produce simple, clear, and meaningful statements to employees. Experience with present disclosure laws on employee benefit plans and on securities teaches that some requirements, though they appear harmless, can be farreaching and lead to federally imposed standard accounting methods and even to substantive regulatory requirements. We do favor statements to each employee showing his vesting status and the order of priority of applying pension funds if the plan terminates, and to the extent feasible, information as to the extent to which each category of employee would be expected to receive benefits out of the funds presently held.

4. Several related proposals described in the committee print, with variants elsewhere, may be classified under the heading of *portability*. Their principal objectives are to preserve pension rights for employees who change employment, and to assure the fulfillment of those rights. These objectives are fully achievable by satisfactory vesting provisions combined with adequate funding.

It is also proposed, however, that these rights be recorded, at the time of employment termination, with a *central registry*. The Equitable believes it desirable to give terminating employees a prompt and adequate statement of the terms of their vested benefits, but the concept of central registration seems costly and unproductive, with no more justification than a central registry for, say, individual savings accounts.

A further proposal is the creation of a *central pension transfer agency* that would take over the pension obligation to a vested employee when he terminates employment in consideration of the payment by the plan of an appropriate amount. There are three major objections to this proposal:

(*a*) Such an agency could become an extraordinary power, reducing the decentralization of pension plan investment. Also, in order to accommodate its administration, it would be likely to suppress the present diversity and continuing innovation of benefit designs and financing vehicles.

(*b*) There are already in existence hundreds of life insurance companies competing vigorously to offer plans of this service through individual contracts and group master contracts.

(*c*) It is wrong to commit a portion of existing funds to individual vested employees as they terminate employment while the employees who continue in employment are not so favored. Nor is the solution to require current individual commitments of funds for all employees, which would often create severe cash flow problems in funding the plan. The best approach is to encourage funding and vesting and disclose to employees the extent to which pension expectations have been assured.

5. Unfortunate or incompetent investment can, of course, undo the good work of funding. This risk is characteristically greater for common stocks and other equity investments than for fixed-income investments, for which, in fact, life insurance companies offer guaranteed performance.

Whether or not this investment risk is to be covered, the proposal that the committee print inappropriately styles *reinsurance* would

undertake in the event of plan termination to supply the pension funds that have *not* been contributed. On a smaller scale, it is as if a Christmas Club member could not only assure the safety of the weekly contribution he does in fact make, but could also arrange to "insure" that if his financial circumstances prevented him from completing his payments, another source would do so.

This proposal is often mistaken as an alternative to plan funding, rather than an additional cost. The cost of pension benefits cannot be avoided. Further, if the employee has been kept informed as to the extent of funding of his pension plan, he is less likely to be disappointed if the plan terminates and funds are not sufficient to provide his benefits fully.

6. The Equitable favors extending the *standards of fiduciary character* now applied to banks and life insurance companies to others administering pension funds and plans.

7. *Wider coverage* by private pension plans should be encouraged by such measures as:

(*a*) authorization by the Internal Revenue Service of prototype and master plans;

(*b*) allowing the plans of the self-employed more of the flexibility available to other employers;

(*c*) higher limits for the income tax deduction for employer contributions to encourage faster funding;

(*d*) clear and simple rules for the integration of private pension benefits with those of social security, directed to the reasonable end result of total benefits in rational relation to earnings at all levels, without regard to the immediate source of plan contributions.

(*e*) deductibility of employee contributions for income tax purposes, with appropriate safeguards (e.g., locking-in) and corresponding taxability of pension income.

Summary

In summary, the Equitable believes that as long as Government leaves to private initiative the negotiation of wages above specified minimum levels, it should similarly leave to private initiative the provision of retirement income above minimum (social security) levels. Further, the private pension movement, which has mushroomed within the past two decades from modest proportions to an accumulation of $100 billion on behalf of 25 million people, is entitled to the informed interest and support of the public at large. Every reasonable support should be given to non-discriminatory plans, however modest their beginnings and however gradual their liberalization. Incentives to more rapid funding and vesting can be increased without revenue loss and to the benefit of the country as a whole. The extension of certain desirable regulation of a fiduciary character and broader policies of meaningful disclosure are in the public interest and should be encouraged. In general those proposals that are likely to be helpful are those that allow wide scope for individual plans and bargaining and impose only broad regulatory standards upon the complex and competitive forces that have produced the extraordinary progress of these past decades.

METROPOLITAN LIFE INSURANCE COMPANY

BY CHARLES A. SIEGFRIED*

In the interest of promoting clearer insight into the role of both public and private pension plans in our enterprise society, we appreciate the invitation from the Joint Economic Committee's Subcommittee on Fiscal Policy to present our views. Financial protection for beneficiaries and retirees has been a prime concern of the Metropolitan Life Insurance Co. for the past 100 years. As you may have noted from our advertising, we are now celebrating our centennial anniversary.

Specifically, Metropolitan's vital interest in the area of pension coverages is evidenced by the fact that at the start of 1967 we held close to $4½ billion in annuity reserves to assure present and future payments to owners of group and individual plans. This amount is twice what it was only 10 years ago and three times the level 15 years ago. Moreover, we look for continued growth of these funds, and through their sound and productive investment will provide regular annuity payments.

THE PRESENT SITUATION

Up to the present time—and it must be emphasized at the outset that this cannot be assumed to be true for the future—growth of Government social security plans, even though characterized by rapid expansion, has probably not seriously diminished the role of private enterprise and individual effort in providing family security.

However, today we are at a crucial point in the area of pensions and their auxiliary benefits. At this time the important thing is to see if there are not some areas where we could all, Government and private parties alike, agree on objectives, such as a stable price level, a sustainable rate of economic growth, and a higher standard of living, and then look to attaining these objectives within the framework of pension planning.

The basic idea advanced here is this: If it is decided that the level of incomes that are to be provided for the retired is to be increased to any significant degree, then a different mix of public and private action should be considered, with emphasis on private pension plans, which by their nature are equipped to perform the capital-raising function as a collateral to their benefit-providing function. The reasoning which supports this analysis is based on three extremely important economic considerations: (1) the need to contain inflation and to correct conditions creating inflationary pressures, (2) the need to avoid taxes at levels too high for long-run healthy economic growth, and (3) the growing need for additional saving to finance capital formation for future economic progress.

In this statement, however, we deal only briefly and for purposes of reemphasis with the need for additional saving to finance future

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capital requirements. On this very important matter, we have worked closely with the American Life Convention and the Life Insurance Association of America, and support the views presented in the ALC–LIAA statement on the need for such saving.

Furthermore, for purposes of this analysis, and for better comparison with private pension plans, we here focus primarily on retirement provisions when referring to the social security system. However, it should also be noted that the relationship between survivor benefits under social security and the role of private life insurance is equally important.

Relationship Between Social Security and Private Pension Plans

While the general purpose of both public and private plans is the same—the provision of retirement benefits—the method of financing social security is very different from that used in establishing private pension funds. And yet it is this very difference which ties the two together. Under our national accounting system, only a rising income-generating capacity of the economy can assure a national income large enough, year after year, to support a social insurance system which can provide benefits to pensioners, dependents, and survivors, year after year. Life insurance companies and private pension funds are two of the main sources of savings accumulations which, when invested, raise this income-generating capacity.

In the case of social security, it can be reasonably presumed that under Government auspices such a system would continue indefinitely into the future. The test of financial soundness, then, is not a question of there being sufficient assets on hand to pay off all accrued liabilities. Consequently, there is no need to actuarially set up reserves as in a private system. Nor is it suggested that such reserves should be set up.

However, in addition to this concept of actuarial soundness, there is also the concept of economic soundness; whether under a private pension plan system or a public system such as social security, it is necessary for the economy to be large enough at the time retirement payments come due to make these payments out of the current year's national income. This can be done in either of two ways. An increasing proportion of the Nation's income can be allocated through taxes to pay retirement benefits, or as a wiser alternative, the proportionate tax load can be held down if savings of a private nature have been funded over the years to build the economy's income-generating capacity.

To legislate, under the public system, pension and survivor benefits of a size which could virtually cripple private enterprise in this function is to surely dilute and eventually cut off these major accumulations of savings from which flow the investment capital to support healthy sustainable economic growth. Unless such funds are available and invested, the economy may not be large enough to make retirement payments.

The Need To Contain Inflation

It is necessary to guard carefully against the inflationary dangers of overexpansion of the social security program. Proposals to amend

social security should be tested in terms of the concept that benefits should not go beyond what is needed to furnish a basic floor of protection. This concept is not inconsistent with the principle of benefits varying within limits so as to bear some relationship to the individual's previous contributions. Indeed, systems not based on variable benefits are especially likely to invite overexpansion.

If social security taxes are insufficient to pay additional benefits, assets of the social security system would have to be reduced by obtaining cash from the Treasury which in turn would have to obtain the cash through deficit financing to pay off Treasury securities held by the system. With savings basically in relatively short supply, such financing probably would be accomplished through inflationary credit expansion. This would have serious adverse effects even as a temporary expedient. Thus, higher benefits would require higher social security taxes. In the case of the employer, these would cut into the dollars available for the purchase of private plans; and in the case of the employee, higher taxes would lead to increased wage demands to replace reduced take-home pay, resulting in inflationary cost-push wage settlements. Consequently, the immediate effects of higher benefits, even if financed by higher social security taxes, could be inflationary.

While there can be no single solution to the problem of inflation, Metropolitan believes that one of the most effective ways to hold the price line is to encourage people to save. Savings act as a curb on inflation, both by reducing the amount of money purchasing consumer goods, and by financing new plant and equipment which produces more consumer goods thus tending to hold down prices. We feel very strongly that the entire country—not forgetting the savers, the purchasers of life insurance policies and retirement annuities, and also the recipients of social security benefits—is entitled to a sound dollar.

Inflation Dangers of Automatic Escalation

Any automatic escalation of social security benefits to take account of rises in the cost of living would only aggravate a basic cause of inflation by adding to demand without creating any additional goods or services. In end result, it does the elderly no favor to increase pension benefits in a way which again drives up prices out of their reach.

Escalation of benefits would be merely a treatment of the symptoms of inflation rather than a remedy for its causes. The 1967 report of the Council of Economic Advisers stresses that if various groups in society "* * * were to succeed in tying compensation to consumer prices, the arrangement would become a vast engine of inflation, which, once it began to roll, would continue to gain speed."

It would be a serious mistake to soften resistance to inflation by leading social security contributors to believe that their future benefits will automatically be increased to offset inflationary loss of purchasing power. To preserve the value of the dollars of the elderly and of everyone else too, inflation must be attacked at its source!

Some Alternative Considerations

In searching for ways to provide sound and substantial retirement income to those of our citizens past the earning years, some new fiscal

thinking is in order which does not automatically include rising Federal Government expenditures and taxes. Higher retirement income can be brought about without permanently increasing social security benefits and taxes. In attempting to suggest some positive alternatives, consideration might well be given to accomplishing a stronger private role in the public-private mix by—

(*a*) Broadening tax allowances to encourage everyone, including employees, employers, and anyone else who chooses, to set funds aside for pension purposes.

(*b*) Raising maximum allowable deductions permitted under current plans.

(*c*) Increasing retirement benefits only for those now receiving OASDHI payments, because their benefits are scaled to a lower earning base. Perhaps also consider those who would start to receive benefits, say, in the next 5 years. However, younger people have time to increase their own personal preparations for retirement by providing for supplements to social security benefits.

(*d*) Streamlining the present pension plan approval procedures.

(*e*) Encouraging the efforts on the part of the major trade associations to make pension coverage available for the smaller businesses.

Price Stability, Low Unemployment, and Economic Growth

In addition to a search for alternatives, we must exert constant vigilance and a determined effort to educate the public in the long-range implications of social security, particularly with regard to costs and impacts on price levels. This would represent an important step in helping to avert inflationary dangers.

Increased education of the public is in fact a must, if we are to understand that it is only under conditions of reasonably stable prices that the economy can enjoy sound substantial growth, at the same time keeping unemployment low and employment high. It is this combination of conditions which will provide the growing national income to not only support a social insurance program but to provide a rising standard of living for everyone. In the long run, we can have low unemployment, good and sustainable economic growth, and price stability by emphasizing that a continued large volume of saving and capital investment in better plant and equipment provides for increased productivity with the least pressure on cost and price levels.

Tax Treatment of Employer Contributions to Private Pension Plans

Some statements in the Joint Economic Subcommittee staff document under consideration raise questions as to whether the present tax treatment of employer contributions to deferred compensation plans should be continued. Since deferring the employer's pension contribution from the employee's taxable income is an incentive for establishing and maintaining a pension plan, the removal of this incentive would seriously weaken the private role. Among the answers to criticisms of this incentive are the following:

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(*a*) The cost to the Treasury is miniscule compared to the increase in Federal social security expenditures that would result if these pension plans were discontinued because of the loss of the tax incentive.

(*b*) Since employers' OASI contributions are not taxable, it is reasonable that the tax on employers' contributions to qualified plans should continue to be delayed until pension payments are received.

(*c*) Pension contributions by employers are a cost of operating an enterprise and should be allowed special tax treatment just as business investment in plant and equipment, since they both meet the long-term needs of the economy.

(*d*) The investment of the funded reserves of pension plans increases the national income base so that it is easier to finance the large amounts of contractual old-age income assurance payments, public as well as private.

(*e*) The advantage of the present tax arrangement to the high income recipient is overstated because, when pension benefits are received, the high income recipient is taxed at a higher rate than the low income recipient.

(*f*) A similar delay of income tax liability is permitted on investment income which individuals earn on Series E savings bonds.

(*g*) The continuing increase in the number of nonworking years points up the need for greater encouragement of effective private programs through the principle of tax-free input and taxable output for retirement plans.

Taxation and Economic Growth

The huge deficit which threatens in the current fiscal year provides a striking example of how quickly the Federal fiscal outlook can change. Just a year or two ago, a major topic was whether expected large Treasury surpluses should be disposed of through higher spending, tax cuts, or distribution to the States. With the important role that the United States is forced to take in international affairs, it would seem a serious mistake to greatly expand future contractual social security payments.

The present fiscal dilemma illustrates one of the dangers of increasing future commitments. This is why it is emphasized on page 123, item *c*, that increased benefits under OASDHI should be limited mainly to persons now retired. Moreover, even without any new expansion of the social security program at all, Federal expenditures apparently are so entrenched that most proposals to avoid the impending heavy deficit advocate only increased taxes—not reduced expenditures. However, a cut in Federal spending has special advantages over a tax increase when economic conditions are as uncertain as they are now. Higher tax rates might dampen the economy at just the wrong time. Reduced take-home pay caused by withholding more taxes could add to the pressure to raise wages and salaries. Higher corporate taxes are often reflected in wholesale and then retail prices. A tax increase might reduce saving more than spending.

Dangers of Financing Social Security From General Tax Revenues

Any notion of raising additional funds for the social security system in whole or in part from general revenues should not be given serious consideration since the direct relationship of benefits and employer-employee contributions is essential for sound legislative accountability. OASDHI is a system of related earnings, payroll taxes, and benefit payments, in which rises in benefit payments can be easily seen to require an increase in either the taxable wage base, the rate, or both.

Legislators who vote for more benefits should at each step be able to determine the degree to which their action will require higher taxes. This accountability would be lost if general revenues were used to finance additional benefits. There has already been some limited departure from the contributory concept. Putting any other parts of social security financing under general revenues would surely lose for the whole program the very important advantage of cost control.

Additional Savings Essential for Real Economic Growth

Two of our most important national economic goals, as indicated earlier, are sustainable economic growth and a stable price level. To achieve these goals, there is a pressing need for additional saving to finance capital formation, and it is essential to the sound operation of our economic system to have the advantages of decentralized saving and investment decisions. Furthermore, carrying forward the main thrust of the ALC–LIAA statement: If the supply of saving is insufficient to meet investment demands, the money supply expands to finance growth, and the resulting increase in credit outstanding causes strong upward pressure on prices.

This anticipated demand for greater savings is of paramount importance in advocating a stronger private role in the private-public pension mix. Economic forces indicate a relative shortage of saving in the future. The expected population distribution, for example, will result in a high proportion of people in the younger working age group and in the retired old age group, both of which characteristically spend rather than save a relatively large proportion of personal income. Middle-age and preretirement age groups, where more is saved out of incomes, will be shrinking as a percent of total population.

Conclusion

As the economy grows, more and more savings is necessary for investment to keep the expanding labor force employed and to help raise its productivity. This ultimately raises the standard of living of the whole population. Life insurance and private pension funds contribute to the economic growth of the Nation because this money is invested in machinery and buildings for production, public utilities, housing, and so forth. Social security, by contrast, tends to reduce aggregate saving because of the redistributive effect of the taxes used to finance the program.

Social security should be regarded as a minimum basic layer of protection, and not as a means for providing the full income desired at retirement. If social security is kept at sound basic levels, employers will be able to provide additional and excellent private group plan coverages. Furthermore, individuals will be able to afford personal supplemental measures. Private plans should wherever practicable contain appropriate vesting provisions, and funds should be conservatively invested to secure certainty of payment of benefits. The plans should provide for appropriate disclosure to assure sound administration.

Private saving accumulations, whether in pension funds or elsewhere, are needed to provide strong, noninflationary, and sustained economic growth, not only for the prosperity of the Nation in general, but also specifically to make sure that programs like social security are able to meet their annual obligations out of national income. Naturally, an expanded system of private pensions would not rule out improvements in the social security program if they were consistent with sound financial and economic development.

STATEMENT OF THE NEW YORK LIFE INSURANCE CO.

The New York Life Insurance Co. has studied the committee print, "Old Age Income Assurance: An Outline of Issues and Alternatives," with some care. We wish to state at the start that we believe there is room for improvement in the present retirement income system, which is essentially a floor provided by the Federal social security system plus a very considerable superstructure provided by private pension programs. The report to the President on private employee retirement plans has indicated a number of areas, including vesting, funding, and portability, where the private systems can be improved. We recognize the importance and desirability of the social objectives reflected in that report. For example, the private programs—to insure that accrued pensions will be paid when due—should be properly funded, and fully vested on completion of reasonable service requirements. We would, however, postulate one caution, that any requirements mandated on the private pension system recognize that funding and other improvements are costly, and must not be raised too quickly to too high a level—a level that would inhibit the growth and vitality of the private system.

Important as these issues are, those raised by the joint committee print with respect to private saving and investment seem to us to be far more important. The argument is made in the print that it is investment, not savings, that adds to our wealth. Saving is dismissed as a deflationary force rarely needed in the American economy. It is suggested that private pension saving is a diversion from other forms of saving, and that it is so contractual in nature that it does not respond to changes in business conditions.

Apart from private savings the only other sources of investment funds that we can think of are monetary expansion and Government savings. We would like to be strongly on record to the effect that neither of these other sources constitutes a safe substitute for private savings in the investment markets. There are obvious limits beyond which bank credit creation or other forms of monetary expansion become highly inflationary, as the history of almost all countries so sadly shows. As to the use of Government savings we doubt if there are many people in or out of the Government who would seriously contemplate the widespread use of Government funds as a source of capital formation. It is hard to see how the private enterprise system could survive for long if the Government controlled and necessarily allocated the funds available to the capital market. It might indeed be possible to maintain a satisfactory level of investment without private savings, but not in the kind of world most Americans want to live in.

In the light of the heavy demands the various objectives of national policy are placing on the economic system, the need for additional investment in almost all lines of endeavor should place a high premium

on private savings—private savings from any source, at any time. We think it would be very difficult to substantiate the notion that pension saving is merely a substitute for savings that otherwise would occur in other areas, and hence contributes nothing to the total volume. As has been argued many times it is a proper function of fiscal and monetary policy to offset the occasional evidences of oversaving that appear from time to time. We think it would be a grave mistake in public policy if the Government were to move in any way that would discourage the further growth of the private pension system and the savings it furnishes to the American economy.

The life insurance industry has submitted a statement that goes into the question of the economic role of the private pension funds in some detail. We subscribe without reservation to the association's views on this very important matter. We think it is in the best interests of all of us, both as taxpayers and as eventual participants in retirement, to see to it that further pension expansion occurs, that payment of the pensions is better assured, and that the private system continues to prosper as an essential supplement to the governmental floor.

STRENGTHENING PENSION EQUITIES THROUGH EMPLOYEE CONTRIBUTIONS AND A CLEARING HOUSE FOR CREDIT*

BY MERTON C. BERNSTEIN **

EMPLOYEE CONTRIBUTIONS TO PLANS

EFFECTS OF NONDEDUCTIBILITY

The declining use of contributory plans is widely thought to be a direct consequence of the federal tax law under which employer contributions to plans are tax deductible but those of employees are not.[1] So, for example, in 1949 the pattern-setting Basic Steel Industry Fact Finding Board recommended non-contributory plans because, among other considerations, each dollar of the tax-deductible employer contribution would result in more benefits than employee dollars which would first be taxed as income and then, after subtraction of taxes, contributed.[2]

This trend away from contributory plans may have been, and probably was, accelerated when it was found that an employee can be given a "raise" equal to his own pension contribution without increasing his current taxes by having the employer assume the employee's pension contribution. This means an increase in take-home pay without an increase in employee income tax and, as a result, a raise which probably costs the employer less than a taxable wage increase.

Where only the employer contributes it should be apparent that government revenue would be no less if both employee and employer contributions, totaling the same amount, were tax free.[3] Presumably, any such treatment for employee contributions would be subject to limitations both upon the amount of permissible employee contributions and the aggregate of employer and employee contributions.[4] There would be a revenue loss if, as might be possible, greater total contributions are made to contributory than to non-contributory plans. If, however, there were an overall limit upon contributions, say up to

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[1] *E.g.*, "The fact that employer contributions to a qualified pension plan are tax deductible to the employer while employees must pay taxes on their contributions is a strong factor in the prevalence of non-contributory plans." *Facts and Trends in Insured Pensions* (Hartfold: Connecticut General Life Insurance Co., 1959), p. 10; and to the same effect, William Haddad, *op. cit.*, p. 76.

[2] Basic Steel Industry, 13 Lab. Arb. 46 at 90 (1949).

[3] Some say that because employee income tax rates are lower than the corporate rate the government loses less when employees contribute and the contribution is not deductible from taxable income. But that probably is not so because the equivalent amount in wages or salary is deductible to the employer and, over the long run, the employer would pay to employees as wages roughly the same amount as it would contribute to pension purposes.

[4] In Canada both employer and employee contributions are deductible within rather strict limits. J. Harvey Perry, *Taxation in Canada* (3d ed.; Toronto: Univ. of Toronto Press, 1961), pp. 55–56.

the present employer maximums, there would be no loss of revenue beyond that possible under the present law other than that paid in taxes on the relatively small amounts of employee contributions now being made.

In discussions of the competing merits of contributory and non-contributory plans little is made of the crucial fact that employees have quite different rights after the employer assumes the employees' contributions. Upon separation from employment an employee under a contributory plan can reclaim *his* contributions, often with interest (albeit generally around 2%). Benefits under contributory plans tend to be higher. Vesting, which boils down to the right, even after separation, to a benefit financed by the employer's contributions, has been more common among contributory plans.[5] Not infrequently, contributory plans give the separated employee the option to leave at least his own contribution in the plan even if he does not qualify for vesting of all or part of the employer's contribution,—i.e., he has a right to a deferred benefit at retirement paid for by his contributions and their earnings, which provides the not inconsiderable benefit of tax-free earnings. As the employer typically contributes more per capita than the employee, the vesting of the employer's contribution is of substantially greater importance.

What are the amounts of taxes "saved" by the employee under a non-contributory plan? Let us look at examples which result from applying formulas in use under contributory plans to an assumed gross income of $4000 from full time employment, a bit less than $2 an hour for a full 2080-hour work year.

For the most part, employee contributions are modest. One plan calls for a *maximum* of $13 a year; the employer contribution is 20 times as great. Others call for $54, $96, $100 and $105.[6] It is the rare contributory plan which calls for more—and then only where benefits are comparatively large.

What is the tax saved if the employer rather than an employee makes a contribution of $100 annually? A married taxpayer (without children) would save roughly $18 in taxes and a single taxpayer $20 a year. Put another way, under a contributory plan they would "lose" $18 or $20 a year in the illustrative situation. A man with children would "lose" less—e.g., an employee with a wife and four children with an income just under $4600 does not have *any* taxable income; a man with a wife and five children and gross income of up to $4650 has no taxable income at 1963 rates.

The employee who is separated without a vested benefit actually loses most of the benefit of the pay increase represented by the employer-assumed pension contribution. All such an employee has to show for the change in contribution method is the slight tax saving—which, on a $100 contribution, amounts at best to about half a cent an hour and, for some employees, nothing at all.

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[5] "In New York State in 1957 about 80% of the contributory single employer plans had vesting, as against 40% of the non-contributory." The authors believed the difference to be narrowing. John McConnell, Charles Pearce, James McNulty, and Robert Aronson, *Vesting and Transferability of Pension Rights* (New York State, Dept. of Labor, 1960?).

[6] U.S. Dept. of Labor, *Digest of One-Hundred Selected Pension Plans Under Collective Bargaining, Winter 1957–58*. B.L.S. Bull. No. 1232, pp. 6–7, 8–9, 10–11, 16–17, 32–33 (1958). All of these are bargained plans between such firms and unions as General Foods and a number of unions, a Brewers Board Trade and the Teamsters, Armstrong Cork and the Rubber Workers, and Inland Steel and the Steelworkers.

And what is the difference for an employer? When an employer assumes a contribution being made by the employee in lieu of an equivalent take-home pay increase, it saves money. To give the employee an equivalent net take-home wage increase the employer must pay that $18 or $20 plus a bit more to offset the tax—let us say it averages $20. If the amount is taken roughly as $20, to an employer whose contributory plan covers 16,000 employees (as in one actual situation) the difference in granting a wage increase of $120 and assuming an employee contribution of $100 a year would be about $320,000 (48% of which would be gained for the stockholders as if it were all profit). In addition to this saving, the employer gets the benefit of contributions made for employees who are separated from employment.

An employer might, however, experience certain disadvantages by changing to a contributory plan. The employer's gains from employees "forfeitures" would be reduced by the amount of a separated employee's refund. If the contributory feature results in vesting, or liberalization of existing vesting rights, the employer also would lose the benefit of forfeitures to the extent of the vesting. In addition, the employer does not include its own contributions to a plan in computing the "regular rate" for overtime or Social Security tax purposes. (Of course, a change in statute could assure continuation of the present situation by affording similar treatment for amounts equal to that contributed by employees.) Nonetheless, if employee contributions are substantial, the employer's net cost might be lower than under an otherwise equivalent non-contributory plan.

When received as retirement income the portion of the benefit attributable to employer contributions on which income tax has not been paid will be subject to tax. Of course, double exemptions for those over age 65 and lower income of retirees will result either in no tax or in taxation at a rate lower than those of the working years. Probably the overwhelming majority of those over 65 are in the non-taxpaying category. However, there is less likelihood of having exemptions for dependents and deductions for mortgage interest payments after retirement than during working life. Part of the tax "saving" effected by shifting the contribution from employee to employer (small as it is to many employees), may be cancelled to some extent by taxation upon receipt as retirement income. What saving is actually effected also depends upon the tax rates in force when pension benefits are paid. Although the 1963–64 tendency is toward reduced rates (hence non-payment of taxes in former years represents a greater saving), future defense, space, and other public sector requirements may result in higher rates (hence lower or no savings depending upon income). The growing proportion of the population over 65, however, may well provide political power to withstand the extension of higher tax rates to those receiving retirement income.

In sum, at present and in the future, unless there are substantial boosts in tax rates, the "saving" to employees attributable to non-contributory plans frequently are negligible; moreover, the "savings" may be more than cancelled out by complete loss of the contribution upon an employee's separation from employment. Thus, change to a contributory plan is advantageous to employees and, in fact, costs them little or nothing. In order to maintain the same level of benefits a shift from a non-contributory to a contributory plan requires larger funds.

But the fact that employer contributions for young employees have earnings for longer periods, and the fact that many incoming employees bring vested credits with them, means that the larger fund requirements need not be met wholly from increased contributions.

Both employees and employers have interests in contributory plans which would warrant tax deductibility to employee contradictions, within specified limits.[7] Rainard Robbins urged such a result with this summary of arguments:

Employee contributions should be deductible in calculating taxable income. Compulsory contributions are not income; while voluntary contributions may be income, a single rule for all employee contributions is desirable. And besides so long as employee contributions are taxable, the tax rule will have an artificial, undesirable influence on the source of contributions to pension plans. Direct employee contributions will be avoided, although they are considered socially desirable and it is well understood that in reality all contributions must come from total production.[8]

It must be recognized, however, that such a result is not easily achieved, for it involves a loss of revenue from employee contributions already being made. Employee contributions in 1961 were estimated to be $780 million, but the estimate may be high;[9] if all of that amount was effectively taxed at the rate of 22% the revenue loss of making employee contributions tax free would be in the neighborhood of $170 million—not a formidable amount of federal revenue. More importantly, other groups probably would seek such favorable treatment for what they regard as, and indeed may be, similar contributions. One such group, the self-employed, won their objective in 1962 with some unsought limitations. In the recent past the standard railroad organizations sought tax exemption for employee contributions to the Railroad Retirement system which are substantial and are scheduled to rise (for employer and employee combined) to 9⅛% on the first $400 of monthly wages. Recognizing that railroad employees could not be privileged beyond employees subject to Social Security (FICA) payroll tax, the railroad unions also urged such exemption for these employee payments and employee payroll deductions under the Civil Service Retirement Act.[10]

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[7] Required employee contributions must not be so burdensome as to favor higher paid employees, i.e., operate discriminately. Treas. Reg. Sec. 1.401–3(d). Generally "contributions of six percent or less are not deemed to be burdensome." Rev. Rul. 61–157, Part 5(g), 1961–2 *Cum. Bull.* 67 at 82. Moreover, employees may make voluntary contributions (in addition to those required for participation in a contributory plan) up to 10% of their compensation, so long as this additional employee contribution does not result in larger benefits from employer contributions. Rev. Rul. 59–185, 1959 *Cum. Bull.* 86. In all likelihood it is the better compensated employee who benefits from this arrangement, by and large.

[8] Rainard Robbins, *Impact of Taxes on Industrial Pension Plans* (New York: Industrial Relations Counselors, 1949), p. 64. More recently and for much the same reasons Dean McConnell, one of the authors of *Economic Needs of Older People* (New York: Twentieth Century Fund, 1956), advocated deductibility for employee pension plan contributions. Statement of John W. McConnell, "Treatment of Pension Plans," U.S. Congress, House Committee on Ways and Means," 2 *Tax Revision Compendium,* 1347 (Committee Print, 1959).

[9] Alfred Skolnik, "Employee-Benefit Plans, 1954–61," 26 *Soc. Sec. Bull.* (No. 4) 4 at 12 (1963) gives that estimate. However, 1962 employee contributions to corporate pension funds were estimated by another agency at $440 million. U.S. Securities and Exchange Commission, *Corporate Pension Funds, 1962,* Statistical Series, Release No. 1902, p. 3 (1963).

[10] At least one objection to granting exemption to OASDI and Railroad Retirement payroll taxes on employees is that this would provide such employees with tax exemption both on contributions and benefits. E.g., Report of Dept. of Health, Education, and Welfare on S. 1313 and H.R. 4101 etc., *Hearings on Amending Railroad Retirement Act by Subcommittee on Railroad Retirement of Senate Committee on Labor and Public Welfare,* 85th Cong., 1st Sess., 11 (1957).

The revenue loss of such deductions, according to Treasury Department estimates, would be on the order of $70 million if limited to Railroad Retirement contributions, $630 million if limited to Social Security employee contributions, and $330 million if limited to United States government plan employee contributions. If all such contributions were made tax free, the combined revenue loss was estimated as $1,030,000,000. If all individuals could exclude retirement contributions up to 7¼% of income, the estimated annual revenue loss would total more than $2 billion.[11]

A potential revenue loss of that dimension raises serious problems. Tax exemption for employee contributions to private plans would have a negligible tax effect (especially if limited to given percentages of income with an annual maximum for any individual, and if the total of contributions were under the same limits as employer contributions are today). It is clear that the revenue loss objection to the same favorable tax treatment for the retirement plan contributions of the self-employed and those subject to Social Security, Railroad Retirement, and Civil Service Retirement tax deductions is much stronger. Many considerations of equity favor preferential tax treatment to Social Security and Railroad Retirement employee taxpayers. Realistically viewed, however, the tax relief aspects of employee contributions to private plans are not of major importance, except for the distorting effect they have upon plans. To the extent that employee contributions replace employer contributions the tax effect would be the same as under the present law—no tax upon the contributions. The important effect would come in the non-tax area—strengthening the rights of the employees to benefits from the contributions made. This is not discriminatory; instead, as noted below, it might help reduce discrimination in favor of highly compensated plan participants.

It should be recognized as a fact of life that the groups seeking exemption for self-employment, Railroad Retirement, Social Security, and Civil Service employee contributions probably will not forego their leverage upon those who may seek tax exemption for contributions to private plans and will, in effect, insist that each should fail until all can succeed. Such action may well result in the continued failure of all groups.[12]

Many will feel that the tax treatment of contributions to private plans should not be considered apart from all other aspects of taxation as they relate to the aged.[13] Moreover, some make the point that such consideration of taxation must be coupled with consideration of the OASDI program and proposed improvements to it.[14] Considering an entire program of taxation for the aged is most logical and appar-

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[11] *Hearings on Tax Deductions for Railroad Retirement Contributions Before House Committee on Ways and Means*, 85th Cong., 2d Sess., 7 (1958).

[12] In 1959, the AFL–CIO proposed the taxation of OASDI and Railroad Retirement benefits and the exclusion from taxable and withholdable income of employee payroll taxes for the OASDI and Railroad Retirement programs. Statement of Raymond Munts, Social Security Department, AFL–CIO in U.S. House of Representatives, Committee on Ways and Means, 2 *Tax Revision Compendium* 353 at 357–358 (Committee Print, 1959), and Munts testimony and discussion, U.S. House of Representatives, Committee on Ways and Means, *Income Tax Revision* 142 at 143–44 (85th Cong., 1st Sess. Panel Discussion, 1959). I have seen no evidence of a drive to achieve this result. Others suggested that making benefits taxable would create pressure to promise offsetting benefit increases.

[13] Such a canvas is beyond the scope of this study, although obviously relevant to it. See 1 *Tax Revision Compendium, op. cit.*, at 539–578 and 2 *Tax Revision Compendium*, at 1301–1396.

[14] Statements of Wilbur J. Cohen (before he became Assistant Secretary of H.E.W.) and Eveline Burns in 1 *Income Tax Revision, op. cit.*, pp. 244–45, 26–61.

ently reasonable; it also is the hardest to do and to legislate, and to that extent is undesirable.

So long as employer contributions are deductible from income (and that is not about to be changed), there seem to be quite strong arguments in favor of giving similar treatment—with similar limitations—to employee contributions.

Union and Management Views on Contributory Plans

In the late 1940's and early 1950's management and labor debated whether plans should be contributory or non-contributory.

Management generally took the view that the plans should be contributory so that employees would be aware of the cost factors and hence more responsible in their demands. The proposition seems quite reasonable, although payment of the employee share by payroll withholding may reduce worker sensitivity on this point. There is no reason to believe that many employers would not still prefer contributory plans, especially if employee contributions were large enough to fund a substantial portion of the plan.

Organized labor espoused (without exception so far as I am aware) non-contributory plans. That union position contrasts with the AFL–CIO's consistent devotion to the contributory principle for the Old Age, Survivors', and Disability Insurance program [15] for much the same reason employers argued for contributory private plans. In addition, organized labor believes that the contributory principle establishes the "right" to a Social Security benefit. But unions also argue that only a non-contributory plan can be made compulsory, and that participation of all employees is the only way to ensure against "adverse selection," whereby older employees, whose pension costs are higher, will join, while younger employees will not. This objection is more apparent than real. There is no question that plans in which all employees participate automatically can be compelled in bargaining. Many unions now contend that the employer contributions to non-contributory plans are a form of wages. If both propositions are correct then mandatory participation in a non-contributory plan is in fact the same as for a contributory plan. There is also the precedent provided by the many universities which require faculty members to participate in contributory plans that in some measure are for the protection of the employing institution. Perhaps union officials believed that members would not favor having a portion of the employee's pay check subtracted for a private program but that such a method is palatable by compulsory governmental action. One may wonder whether either assumption is correct. In 1958 proposed increases in the Railroad Retirement payroll tax to support improved benefits was opposed by many railroad workers, although increases in both benefits and taxes were enacted thereafter. Organized labor has strongly supported repeated increases in the OASDI payroll tax on both employers and employees as a means of improving benefits, and I am not aware of opposition to these increases by members, although the increases have not yet taken full effect.

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[15] Nelson Cruikshank (then Director, Social Insurance Activities, AFL; now Director, Social Security Dept., AFL–CIO), "Some Labor Views on the Social Security Program," in *Proceedings, Industrial Relations Research Association,* 183 at 185 (1953). Of five basic principles he listed for OASI its contributory character was the major element of two.

Desirability of Contributory Plans

It seems reasonably clear that, especially over the long haul which pension financing requires, the employer funds allocable to the wage bill probably are not very elastic. This is not revealed truth, nor can it be demonstrated empirically, because negotiators cannot afford to disclose how much better or worse the bargain is than their predetermined goal. The conclusion is based upon the nature of bargaining over pensions and other fringe benefits and the expressed opinions of union and management representatives. In sum, it appears a reasonable hypothesis, even if not a demonstrably certain conclusion, that employer pension contributions are nothing more than part of the wage bill which would otherwise be applied to wages or other fringes. At least from the union point of view, employer contributions are deferred wages.[16] This makes somewhat disingenuous those not-so-rare union pamphlets on pension plans which make much of the fact that the program is financed "solely by the employer[s]."

But unions and employees are kidding themselves, it seems to me, if they honestly believe than a non-contributory plan results in greater economic benefits for employees than contributory plans. The evidence on benefits and vesting—as far as it goes—is against them; opinion of informed commentators is against them; their own position on OASDI financing is against them; and the foregoing analysis is against them. Maturity and realism should counsel that, as with Social Security, employees have greater security and more leverage in the operation of contributory than non-contributory plans.

Moreover, we have seen how ineffectual the anti-discrimination provisions of the Code regulations and rulings may be, so that in fact employer contributions can redound mostly to the benefit of management officials where employee separations are numerous. In contrast, whatever dollars are contributed by an employee are practically universally returnable to him, often with interest, upon separation—and, as observed, vesting has been more common in contributory plans.

The revival and expansion of the contributory method would be a powerful, practically a self-enforcing, preventive measure against favoring management elite, for it would be impossible to divert the employee contributions to the benefit of the not-to-be-favored groups. In addition, to the extent that *effective* vesting is promoted by employee contributions, the prohibited discriminations are more readily prevented.

Undoubtedly, proposals for a revival of contributory plans are a case of swimming against the stream. Whether the foregoing analysis can help revive interest in contributory plans is rather questionable. It is not very questionable that the initiative for changes in tax treatment of employee retirement plan contributions must come from outside Congress; the effective lead cannot be taken by legislators, already overburdened with demands for legislation by organized groups.

Realism seems to favor a revival of the contributory plan and, per haps, tax changes to stimulate it or, more accurately, to remove the present tax encouragement for non-contributory plans. Whether realism is a sufficient force remains to be seen. Let the cynics give an

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[16] E.g., union brief in Inland Steel Co. vs. NLRB, 170 F. 2d 247 (7th Cir. 1948).

unreserved "no"; others of us live in hope, even if not with vibrant expectations.

The policy of according deductibility to employer contributions but not to employee contributions should be reconsidered and reversed, because employee contributions strengthen employee benefit rights and minimize discriminations in favor of stockholders and highly compensated employees.

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TRANSFERABLE CREDITS AND CLEARING HOUSE DEVICES

In this country no device other than vesting or multi-employer plans has been seriously considered to provide retirement income to able-bodied employees separated before retirement age. No proposal for vesting in the United States has included any device or institutional arrangement whereby vested rights follow the employee, rather than, as at present, having the employee and his credit go separate ways until retirement.

The possibility of small, perhaps miniscule benefits, the incompatibility of benefit provisions, disproportionately high administrative costs, attrition of fixed benefits by inflation, withdrawal of contributions, their lack of utility for the disabled, and the non-participation of vested deferred benefits in plan improvements, all argue for the desirability of collecting the bits and pieces of employees' vested pension credits into one more adequate benefit, a benefit based upon contributions which have earnings and growth up to the date of retirement. Indeed, as will be shown, such a combination of credits can facilitate liberal vesting. Outside of the multi-employer plans, such piecing is not presently possible; no device exists in this country for transferring and cumulating credit. In my discussions starting in 1959 with officials of insurance companies, banks, pension consulting firms, unions, management, government, and academics I found interest in some device to coordinate plans or benefits. But I encountered no fixed ideas, except that some want to exclude or minimize the role of the federal government. A basic purpose of this book is to provide fairly concrete suggestions for institutional arrangements to enable employees to carry all or some of their pension credits with them. I suggest a set of alternative institutional arrangements as a basis for discussion in solving the problems of pension, which are coming to be recognized, and the shortcomings of vesting as now practiced, which have yet to be widely recognized.[17]

[17] The outlines of my ideas were first presented to specialists in this field and the Board of the Meyer Institute in late 1959 and discussed with others throughout 1960 and 1961. The Ontario proposal for a Central Pension Agency, presented in the February 1961 *Summary Report of the Ontario Committee on Portable Pensions*, has some similarities to a few of the following "clearing house" proposals. It first came to my attention in late August 1961 after my own first draft on clearing house devices was written. I mention these details to show that similar notions were developed independently by a group of experts and by me, working separately, to deal with the same basic problem. The Canadian proposal and my alternatives have several significant differences, described below.

TRANSFER VALUES

At least 24,561 pension plans were in force in the United States in mid-1959,[18] varying in coverage from a relative handful of employees to tens of thousands. About 7,800 plans were for groups under annuity or deposit administration plans with insurance companies.[19] Roughly 15,000 plans were administered by trustees—generally management personnel or bank trust companies. Eligibility, administration, benefits, contributions, funding medium (insured, trusteed, or some combination), and funding method (level, pay as you go, profit-sharing) are anything but uniform. Some object that "complete portability of pension rights might require 'pooling' of the responsibility for making the ultimate benefit payments. This would mean uniformity in benefit formulas, eligibility requirements, retirement provisions, and financial policies to a degree which appears impractical in view of the wide diversity which exists today in all these matters." [20] These and similar objections apparently are based upon the vesting of benefits without portability of the funds underlying them, i.e., "cold storage" credits as they are sometimes known. I suggest that the objections are not valid.

How then can benefits be carried from one plan to another dissimilar plan and perhaps later the credits from both imported into a third? No arrangements for such transfers now exist, but the medium for doing so exists.

It is money.

DESCRIPTION

At any given point in time it is possible for an actuary to place a monetary value upon the pension credits of an employee. The appropriate bases for such valuations are not a matter of settled practice by actuaries and several alternate methods are possible.[21] The 1957 report and discussion of the Spratling, Bacon, and Bromfield study, sponsored by the British Institute of Actuaries, emphasize that, despite differences of opinion as to precisely the best and fairest methods to employ, there are several reasonably good ways of making such valuations which, while intricate, can be done routinely.

Under a voluntary credit transfer system the valuation process would be determined by the parties to plans. A workable system of "transfer values" does not require that every element of valuation be fully agreed upon as rendering precise justice for the separating employee, the employer, and those who remain behind. For the separating employee, something to transfer is better than nothing and

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[18] U.S. Department of Labor, *Characteristics of 127,657 Welfare and Pension Benefit Plans*, B. L. S. (processed, 1960) Table I. This was based upon filings under the Welfare and Pension Plans Disclosure Act for plans covering "more than 25 employees." The Secretary of Labor believed that a large number of plans were not reported; it can be reasonably assumed that the plans for which reports were not filed for the most part covered small groups of employees.

[19] Not included are 17,870 individual policy pension trusts (life insurance plans with pension features) covering about 670,000 persons. 1960 *Life Insurance Fact Book* (New York: Institute of Life Insurance, 1960), p. 35.

[20] U.S. Department of Labor, *Pension Costs in Relation to the Hiring of Older Workers*, B.E.S. Rept. No. E150 (1956), p. 15.

[21] They are discussed rather fully in F. H. Spratling, F. W. Bacon, and A. E. Bromfield, "Preservation of Pension Rights," 83 *Journal of the Institute of Actuaries*, pp. 173, 184–187, 188–189, 191–195 (1957) and Abstract of Discussion [on that report] *idem* at pp. 202–224. The article was a result of a study made under the auspices of the British Institute of Actuaries.

a reasonable amount transferred can be far more valuable than a "cold storage" vested right; indeed, the transfer can overcome the several drawbacks of vesting described in the previous chapter. Those who have the power to decide upon the valuation method, the employer alone or the employer and union in bargaining, may agree only to transfer *part* of the then present value of credits, as under a system of "graded vesting." There is a certain element of arbitrariness in the whole system of actuarial analysis and computation (necessarily so), and another slightly arbitrary set of assumptions or methods should be bearable.

This sort of valuation is done routinely in Norway where white collar workers' private pension credits are universally transferable. Setting such "transfer values" has proved to be no problem.[22] The value of the separated employee's past credits are simply transferred to the plan into which he moves and the new plan gives him whatever credits he is entitled to by virtue of the payment made. As between the four companies which make such transfers (all of the insurance companies dealing in pensions in Norway), the transfers are made as bookkeeping transactions and net differences settled in cash from time to time. The insurers also receive transfer value in cash for employees transferring from non-insured plans. Apparently there should be no difficulty in establishing the value to be accorded by the receiving plan to the credits which an employee brings with him. In effect, the money received would be translated into some equivalent years of credits under the plan into which he moves.

Whenever a plan is less than fully funded, the award of a fully paid up benefit or credit to a separated employee favors that employee to the possible detriment of the employees who remain behind in the plan. Part of the funding for their benefit is removed, and what remains might be inadequate to meet their valid claims if the plan were terminated soon thereafter. To allow for this contingency the credit to be conferred upon departing employees could vary according to the state of funding. Payments from the old plan to a new plan could be paid in installments to minimize the possibly adverse impact upon the old plan. This feature may raise a problem with the Internal Revenue Service as possibly not a "definitely determinable benefit." But I.R.S. might well be flexible in view of its enthusiasm for vesting. Moreover, as the various plans proposed may require federal legislation, such arrangements could be exempted from the "definitely determinable" requirement if otherwise satisfactory. And if a plan must use the same formula for computing the transfer values of entering and exiting employees, windfall gains to the receiving plan can be forestalled.

Experience under a transfer scheme could develop more or less standard criteria for valuing the credits of exiting and incoming employees, thereby making possible continuity of credits and participation in growing plans presently denied to tens of thousands of employees who lose or leave jobs covered by plans.

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[22] Interview with Eigil Möen, Assistant Chief Actuary, Norske Folke (Norway's largest life insurance company), July 1959. Individual plans vary greatly as to amount of benefits, disability coverage, etc.

PLAN PROVISIONS FOR TRANSFER VALUES

Plug and socket arrangements

Transfer value schemes would require plan provisions to give transfer credits to separating employees and to give an employee entering a plan credits for the amount of money he brings with him. Should an employee not move directly to an employer with a retirement plan but do so subsequently, the credits could be transferred when he next enters employment with a plan. Whether such a delayed transfer credit would be of the value at separation plus all or some of the earnings up to the time of actual transfer or without any of the earnings is a matter for individual determination. The crediting of earnings to the transferee would diminish the fund available to remaining employees, but no more so than a cold storage credit may. As the loss per capita would be small to those who remain, but the gain would be proportionally large for the individual transferee, it may be little or no strain to give the transferee the benefit of the full earnings. Upon leaving the second employer and going to a third, a similar transfer could be made. It would seem only fair that with each shift the employee would be given *full* credit for everything he brought with him, plus earnings on it—even if the second employer has a graded system of vesting under its own plan. However, the proposition is not revealed truth and some may view the matter differently

The mechanics are no great problem once plans are supplied with the provisions for such financial plugs and sockets. Both plans, the one the employee leaves and the one he joins, must have provisions for the transfer. Only the last plan would be responsible for the benefits, under its own formula—having received and credited value from all prior plans in which the employee participated. Or a central agency, as described below, could receive the value of the departing employee's credits.

Once the large plans (at least those with vesting) adopt such provisions, their use would undoubtedly spread. The only uniformity required is accommodation for cash transfers in and out of the plans. All other elements of the plans could be as dissimilar as imaginable.

Transfer at Retirement Age

The Spratling, Bacon, and Bromfield study suggests the possibility of combining ordinary "cold storage" vesting with a transfer value system under which credits from all plans under which an employee worked would be transferred to the last employer when the employee reaches retirement age.[23] However, this arrangement, the authors said, might have the undesirable effect of embarrassing the last employer if the resultant benefits differed markedly from those given retirees with similar service accumulated wholly in the last employer's service. They were of the opinion that otherwise such a scheme presents "most of the advantages and few of the disadvantages of both systems" (i.e., cold storage and value transfer). This is a little hard to follow. Such a scheme would obviate the multiplication of costs of administering several benefits but would not overcome *any* of the other already described drawbacks of cold storage vesting, especially exclusion from plan improvements after the employee's separation.

[23] "Preservation of Pension Rights," *op. cit.*, esp. pp. 212–213.

Probably under this alternative method the valuation problems are easier to handle in both the transferring and accepting plans because at retirement age the employee's credits have a determinative value under the plan; all the receiving plan need do is combine all the money and either buy whatever annuity the sum will purchase at regular rates or give the "benefit" it would result in under the last fund's formula—both routine matters. But such a system contemplates that the plans which accord the vested rights continue in active existence to the dates of retirement of employees separated with vested rights. This is an assumption which may be entirely too optimistic, particularly for small company plans. In my judgment, only credits transferred at the time of job separation into another group plan can fully overcome the present limitations of vesting and fully realize the benefit of a transfer value system.

Transfers Costs and Charges

Under any transfer value scheme the plan from which an employee's credits are transferred incurs some costs in collecting his records (probably quite routine), valuing his credits, communicating the transfer to a clearing house or directly to another plan, and recording the completion of the transaction upon receipt of acknowledgment by the receiving agency or plan. These operations are similar to those at retirement, although the valuation might be more complicated, at least until standardization is achieved. As only one transfer is involved, the transferring plan is relieved of the burden of annuity or benefit payments; hence the transfer value transactions may actually involve less cost than processing a regular benefit.

There are no exact precedents or experience for the transfer of credits (and cash) for individuals. Of course, vested rights to a deferred benefits administered by a plan involve some cost, but no direct charges against the plan are made for that item. Under a group annuity plan, employee separations without benefits result in credits to the employer's account of something slightly under 100% of the amount which had been credited to the separating employee. These charges often are made up even though "loadings" for costs and contingencies also are charged.[24] No charge is made, normally, for separations under deposit administration and trusteed plans.[25] Under a bilateral or clearing house arrangement, whether private or public, it would be desirable to minimize the costs and charges for transfers. Probably experience is needed to minimize transfer costs. It may be pertinent to note that in Norway no charge is made by the insurance companies for transfers.[26]

EFFECTS OF TRANSFERABILITY

Effects for Older Workers

Many workers in their 40's, 50's and 60's, once out of work, have great difficulty in finding any employment when jobs are not plenti-

[24] Dan McGill, *Fundamentals of Private Pensions* (Homewood, Ill.: Richard D. Irwin, Inc., 1955), pp. 95–96.

[25] Willard Weiss, "A Critical Analysis of Trustee and Insurance Company Administered Employee Retirement Plans," 5 *Proceedings* Conference of Actuaries in Public Practice, 1955 (reprint. ed. for Eugene Klein & Associates, Actuaries, Cleveland, Ohio), p. 176.

[26] Interview with Eigil Möen, Assistant Chief Actuary, Norske Folke, Oslo, July 1959.

ful.[27] Very likely the skilled do better than the less skilled, at least so long as their skills are in demand. Those who do gain employment have lower seniority than their fellow workers and are most vulnerable to involuntary separation. When separated at yet higher ages, their prospects are even less enviable. Judging by the substantial and stubborn unemployment figures of recent years, the unemployed elderly are all too numerous. During the next decade or so, the relative scarcity of workers in the 30–45 age group may improve matters for older job seekers. Perhaps by the 1970's the problems of older job seekers will have been reduced by education and economic growth. Equally possible, and more probable, is that technological advance and accompanying overseas competition will continue to shrink job opportunities while the labor force grows.

Many older members of the labor force separated from long-held positions must piece out the time before reaching Social Security retirement age with short term jobs as best they can. Under such circumstances an employee will have had to make all or most of his provision for private retirement income in his prime (younger) working years. And if, as their numbers grow, the job opportunities for older workers decrease, it will be that much more desirable for the younger years to be years of effective saving for retirement. The period between pension contribution and retirement the less need to be contributed for any given level of benefits or the easier it is to provide a larger benefit.

To the extent that older workers experience substantial unmeployment in their later years, or are employed for periods too brief to qualify them for vested or normal benefits, the single-employer plan pattern is decidedly less desirable than a system of transferable credits. This much can be said with reasonable certainty: the more years in which employees earn creditable pension service, the closer to adequate will be their retirement benefits. For many tens of thousands of employees this will require pension credits from more than one employer, or even more than two or three employers.

Moreover, there is some evidence that pension considerations operate to hinder older job seekers in obtaining employment. It is thought that some employers with plans do not hire older workers because their pensions would be either substandard or would cost too much to be made more equal to those of long-term employees.[28] If this is so, and it is widely believed to be so, an older employee with a substantial vested benefit or a block of credits earned in prior employment which can be transferred to the plan of a potential employer would be more employable.

Effects on Employee Turnover

Transferability is desirable because of the strong possibility that hundreds of thousands of employees will be changing jobs, voluntarily

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[27] See, e.g., U.S. Senate, Special Committee on Unemployment Problems, *Report,* Sen. Rept. No. 1208, 86th Cong., 2d Sess., 151 ff. (1960). An excellent collection of articles on the subject will be found in U.S. Senate, Special Committee on Unemployment Problems, *Readings on Unemployment* (Committee Print, 1960), pp. 758–825.

[28] E.g., Margaret Gordon, "The Older Worker and Hiring Practices," 82 *Mo. Lab. Rev.* 1198 (1959); Canadian Dept. of Labour, *Pension Plans and the Employment of Older Workers* (Ottawa, 1957), presents the strongest evidence—statements by employers as to their policy. Also see U.S. Dept. of Labor, *Pension Costs in Relation to the Hiring of Older Workers,* B. E. S. Rept. No. E150 (1956).

and involuntarily, and may thereby lose their pension credits. In large part it is suggested as a response to turnover.

Yet some may object that transferability would stimulate employee turnover and thereby defeat one of the principal purposes of private plans. What evidence there is indicates that pension plans do not tie workers to jobs. (Executives are another matter.) So this objection probably is insubstantial. Indeed, transferability may be such an attractive feature that it would hold employees; or conversely, a plan without it, once it came into fairly common use, would be considered inferior and less attractive. Moreover, it has been pointed out that employees who are held by non-vesting features of pension plans, because they are anxious about their retirement savings, often are the marginal employees whom the employer least desires to keep.[29] Employers who feel the desire to use pensions to keep employees can employ a system of graded—and transferable—vesting. In this way the employer would feel that its purposes are served, yet the employee's interest in steady accumulation of pension savings would be protected also.

Unless it is hopelessly naive to believe that the ultimate justification of pension plans is that they provide income to employees when their earnings have declined or stopped, it would seem that transferability serves the basic purpose of plans. And it is in the interests of the private pension system, for if the system is not adequate to the needs of employees under plans it will become discredited.

TRANSFERABILITY FACILITATED BY A CLEARING HOUSE

Whether individual plan provisions, without supporting institutions or devices, are sufficient to facilitate transfer values for exiting employees is to be doubted. There are today so many insurance companies and bank and other trustees administering plans that the problems of communication alone could be formidable. The transfering employee would have to inform the new plan of his credits under the plan in which he had participated. The new plan's officials would have to inform the old plan's officials of his new employment and inquire about transfer value provisions of the old plan. Further exchanges of correspondence might be necessary to establish the bona fides of the new plan (if the first plan prohibits cashing out of vested benefits); valuation problems may arise if the old plan wants assurance that the employee will get full value for the funds transferred to the new plan. Eventually the transfer would be made. If this had to be done by a plan for hundreds of employees in a year, or even thousands, the arrangement could bog down in a morass of paper.

A "clearing house" could facilitate and, in addition, supplement the transfer value provisions of individual plans—and thereby stimulate them. Indeed, such an arrangement might be the indispensable condition of a workable system of transferring pension credit values.

[29] This paragraph is based upon Spratling, Bacon, and Bromfield, *op. cit.*

A Pension Credit Clearing House

POSSIBLE FUNCTIONS OF A CLEARING HOUSE

A pension clearing house could perform one or more of the following functions:

1. Maintain records of "cold storage" vested credits, with the credits themselves remaining with the plan under which they were earned.
2. Facilitate the actual transfer of the value of vested credits for employees leaving one plan and entering another.
3. Receive tranfer values for separated employees who do not enter a new plan, thereby providing the advantages of a developing group plan.
4. Provide basic coverage for small groups of employees for whom regular plan coverage is impractical due to high costs and the uncertain longevity of the job, or, indeed, of the employer.

Any of these functions could be performed by a wholly private or wholly governmental agency or any one of several private-public cooperative arrangements. These alternative devices are described and explored in some detail after a description of the manner in which the functions enumerated could be performed.

Maintaining a Pension Registry

As already noted, some management and bank officials oppose vesting in the belief that it entails too great a record-keeping burden. In addition, there is a problem of the inadequacy of records (and memories) of separated employees. A central pension registry could preserve individual employee records of vested credits as they are awarded and maintain up-to-date information about the plan under which the credits were earned. When the employee reaches eligibility, but is unclear as to the location and amount of all vested credits, he would ask for his record at the registry and, on the basis of it, he could apply directly to the appropriate insurance companies or trustees for his several benefits. Such an arrangement does not overcome any of the limitations of vesting as presently practiced except record maintenance.

Facilitating Transfer of Credit Values

A clearing house could facilitate the transfer of credit values for employees passing from one plan to another, thereby reducing, if not eliminating, individualized handling of each transfer, and the attendant cost. The following description is suggestive of how a clearing house could operate.

The similarity to a check clearing house is obvious. Plan-administering institutions, would register plans to establish their identity and receive code numbers either in expectation of transfers or at the time a transfer is made. (Periodic updating of registrations would be in order, especially to keep track of smaller plans.) When an employee leaves a plan with a vested deferred right to pension benefits he would receive a certificate to that effect, showing the plan name, clearing house code identification, the date of the transfer, the value of his credits, and the employee's name. Whenever a transferring employee obtains a new job which has a plan he presents the transfer information to the new employer. An employer with a plan which accepts

transfer values takes the certificate and its plan administrators submit it to the clearing house (with information about the receiving plan, if not already registered and its identity established). The clearing house would record the transaction, remit the certificate to the issuer, and credit and debit the accounts of both plans appropriately. Periodically accounts would be settled. The transfer values might be subject to the consummation of the cash transaction so as to cover those instances in which an issuing plan might not be able to make good on certificates.

In all likelihood a clearing house limited to this purpose would be a cooperative or non-profit association or corporation rendering service at cost. If the clearing house were also to provide group coverage (as considered in the sections which follow) the simple transfer operations also should be at cost. However, some of its operations—such as the study, and possibly establishment, of transfer valuation methods—would require capital. The New York Vesting Study [30] opines on the subject of pension registries and clearing houses that they would be an aid to small employers but that "presumably" large firms, insurance companies, and "some banks" would find it more economical to handle their own vested accounts. Note that the comment was limited to records of vested rights of the kind presently accorded. The comment would seem inapplicable to a system employing the transfer of the value of vested rights to another plan or a central agency since there would be nothing left for the old plan to handle. Not the least of a clearing house's advantages would be the standardization of transfer practice—itself a source of economy—and, perhaps, the establishment of standards for valuing transferred credits.

Providing Coverage for Transferees to a Job Without a Plan

The clearing house also could provide group coverage for employees separated from a job with a plan and not subsequently covered by another plan. In this way, the last employer's plan could clear its books for the employee by paying the cash equivalent of the separated employee's credits (even if quite small) to the clearing house. This would give the individual employees the benefit of group coverage; diversification of investment, for security; expert management, and hence good earnings; a large fund with low per capita overhead costs. The continuation of earnings by his credits under current rates would help offset the attrition of value due to inflation before retirement.

Individual employees whose credits are transferred into a clearing house group plan may not obtain a job providing pension plan coverage for some time—possibly never. To guard against this possibility, or merely to enhance retirement income, individual employees might want to augment their pension credits by making their own contributions. There would seem to be no reason to exclude employee contributions to the clearing house group plan—so long as the plan operated on a fully insured basis and the dollars contributed "purchased" their exact equivalent in benefits and were not "subsidized" by the contributions of others or by the government.

However, insurance companies may feel that such an opportunity would compete with their individual annuity business. It might, but

[30] John McConnell *et al., Vesting and Transferability of Pension Rights* (New York State Dept. of Labor, 1960).

only on the fringes. Perhaps, the right to make their own supplementary contributions could be limited to employees with incomes of, say, under $7500 or $10,000, who are not good prospects for individual annuity policies. The arguments in favor of participation by the self-employed and the non-covered employed are just the same as those for extending OASDI coverage to the self-employed and near universality for the employed. Participation by them would be wholly voluntary. Perhaps there should be income limitations upon participation by the self-employed so as not to give cut-rate competition to insurance companies where now they are rendering acceptable service.

Providing Group Coverage to Employees of Small Companies

A group pension plan may be beyond the reach of many employee groups, particularly small groups. This is especially true of employers who are uncertain about their ability to sustain a plan. Moreover, plans for employees whose jobs are of uncertain or relatively brief duration are not presently practical unless there is some unifying factor—such as craft status—which has led to the creation of a multi-employer plan.

The clearing house could provide low cost group coverage for employees of small companies (say up to 250 or 300 employees)[31] to meet these problems. In effect, the employees would be members of the clearing house group plan with the employer making contributions for them. Upon separation from such a job, employees would continue to be group plan participants with the option of supplementing their credits by individual contributions. If they were unable or did not desire to do so, their already paid-for credits would continue to participate in the earnings of the group plan and would be available for transfer into another private employment plan.

Most, or a large part, of the clearing house coverage so provided would be "new business," but some undoubtedly would represent funds which otherwise would have stayed in single-employer plans either as "gains" from employee separations or as vested rights to deferred benefits. But, as I propose to show in the next section, such losses need not be net losses.

WIDESPREAD USE REDUCES COST AND ENCOURAGES VESTING

A clearing house probably would effect economies in the administration of vesting. More importantly, if a clearing house was widely used, the cost of vesting could be reduced, perhaps substantially. Presently the cost of any vested rights conferred by a plan is borne by that plan alone. Whatever the pattern of employee turnover, under conventional vesting all the money is outbound. Under a clearing house (or mutual bilateral) arrangement some incoming employees would bring funds with them. Of course, the incoming employee would get the full benefit of any funds he brings and so there is no "profit" to the plan he joins on that account. *But to the extent that employees arrive with money for credits, the receiving employer*

[31] Applying limits of this sort is a little tricky on the margins, particularly for new or young enterprises, as employment increases and decreases. Groups which grow beyond the limit—as measured by average employment during the preceding two or even three years—might be required, on notice of several months or more, to obtain more conventional coverage. This limit, or at least its details, would best be set after a thorough examination of the factual situations involved.

is required to contribute less in order to provide any given level of benefits. Therefore the receiving employer can base his plan on a longer period during which pension credits are earned.

For example many plans limit participation to employees with specified age and/or service. In effect, this can and does exclude considerable periods of employment from pension credit. And, it excludes the earliest years whose contributions would be of the greatest value because they have compounded earnings for a longer period. In effect, under present practice the employer is financing each retiring or early retiring employee's benefits over a period of, say 30 rather than 40 years. For any given amount of normal or early retirement benefit the employer must contribute more for that employee, and the contributions will have very substantially less earnings and less earnings on earnings—all tax free. Under clearing house arrangements, the older the incoming employee the less is the burden to the receiving employer of providing a decent benefit if that employee brings (in money) some or all of the pension credits he earned elsewhere.

Some may say this is "taking in each other's wash"—that if each did his own it would be the same. The reply is that it would *not* be the same because under schemes contemplating the funding of every employees' benefits over a longer period, more of the benefit financing derives from earnings rather than contributions. And it is to be hoped that by reducing the cost of each year of plan coverage more employers would be able to provide plan coverage and transfer value vesting. *The more plans utilizing the clearing house and providing transferable credits, the less expensive it would be for each employer to provide a unit of coverage.*

So, for example, the per capita annual costs of providing full vesting to an employee achieving pension credits under a universal transfer-value clearing house for every year of work between age 22 and 65 may be less than one third the cost of a 10 year vesting provision. Obviously the savings for employees who are older when universal transfer-value arrangements are instituted would be less. And the problems of financing benefits for those near retirement would remain what they are today; decent benefits cost proportionally more for them. Quite clearly, however, the savings possible under a universal transfer-value clearing house system are substantial—indeed, dramatic. But, if they are to be gained the system must be put into operation as soon as possible. Of course, the aggregate amount required to finance pension benefits would be greater, but much of the increase would derive from fund earnings. And, as the earnings are tax free to the fund, they are commensurately more productive than if they were used for regular business purposes and put into pension plans later.

But what, it may be asked, would be the incentive to give as well as receive the benefits of the system? Several forces would be at work. First is the force of competition. Transferability would be an attraction for desirable employees (how strong a factor depends upon many variables), once it is introduced, employers would be under pressure to match such features in others' plans. Secondly, collective bargaining would tend to spread the feature of transferability.

The clearing house, whether private or governmental *if* it seemed desirable to add further inducements, *could* set a deadline (of perhaps several years after inception of the clearing house or inception of the

plan) within which plans would have to provide for giving transfer credits as a condition of eligibility to receive transferees' credits through its machinery. I rather doubt that even this degree of compulsion would be necessary. At the most it might be useful for a few marginal employers.

The results of a clearing house transfer-value arrangement would be reduction of the cost of providing any year of plan coverage, so that the wider the use of transfer values, the less costly would be plan coverage. This in turn can bring plan coverage within the reach of those to whom costs are prohibitive under single-employer plans. And the clearing house transfer-value system would promote the vesting of credits for short periods of service which otherwise would not be amenable to vesting.

HOW A CLEARING HOUSE PROVIDING EMPLOYEE GROUP COVERAGE WOULD WORK

Basic Arrangements

Most schemes for a clearing house, whether providing for operation by private, federal, or by a joint federal-private group, would function in essentially the same fashion.

Employers would "contract" for a period of time to provide clearing house coverage for employees separated from private plans. The "contract" would provide that all employees separated under age and service conditions specified by the employer (entirely at its option or in conformity with a collective bargaining agreement) would be given transfer value credits computed in a specified fashion which would be paid over to the clearing house. In the event of plan termination, the value of vested credits could be transferred to the clearing house rather than dissipated in cash payments or paid-up annuities for small amounts. The contract requirement of equal treatment would not be so much to protect the clearing house as to ensure fair operation of each employer's plan. As already described, small companies could contract for clearing house group plan coverage for all of their employees.

After an employee's separation from a job covered by a private plan his pension credits would be evaluated. The employer would file a report and payment for the separated employee, or perhaps make payments periodically. If the OASDI machinery were used for either a private or public system, the report and payment would accompany the employer's report and payment of Federal Insurance Compensation Act payroll taxes (Social Security payroll taxes). That supplemental report would show the employee's name, his Social Security number, the amount to be credited to his supplemental retirement account, and his age.

Contributions and Benefits

Basic to a supplementary system grounded in private plans is adherence to private insurance principles—which means primarily that benefits will be proportional to contributions, rather than accommodated, in part, to the insured's need, as in the OASDI system. On this point I have found no disagreement among those with whom I have discussed such arrangements, whether they are in government, unions, management, insurance, banking, or pension consulting. The

voluntary nature of the program would seem to indicate offering benefits essentially commensurate with the individual's savings. But, some private plans weight their formulas in favor of lower paid employees; this pattern could be maintained by making proportionally larger contributions on their behalf to the clearing house plan.

Under present plans (except for deferred profit-sharing plans) either contributions or benefits (perhaps both) are fixed, and contributions are made according to the same formula over a period of years, with specified or ascertainable amounts of benefits as the goal.

However, a clearing house, if it is to be adaptable to varying needs, could not operate with either fixed contributions or a fixed schedule of benefits to which each participating company must gear its contribution or to which individual employees must adhere as in a privately purchased individual annuity plan. Rather the contributions would be much as they are under private plans today—varying from plan to plan and in conformity with each company's contributions formula. Separated employees would bring to the clearing house plan varying amounts of money representing different service, different formulas, and, indeed, different percentages of the contributions or premiums paid for them. Plans could confer the full value of their credits or some fraction; the only limitation would be against invidious discriminations. Similarly, varying rates of contribution would be made for employees whose basic coverage is provided by the clearing house group plan; as they move to different jobs also covered by the clearing house group plan contributions on their behalf might—probably would—vary. This system could include transfers from profit-sharing plans. The central group plan would credit each employee with whatever credits his transferred value will purchase, taking into account his age, much in the manner of insurance arrangements. Only if age were a factor would there be protection against "adverse selection" of risks in which the high cost elderly would gravitate toward the clearing house plan with employers using other private methods for "lower cost" young employees.

As to benefits, the plan could guarantee a fixed dollar amount at retirement in accordance with regular insurance practice. Favorable fund earning experience beyond the necessary reserves could be reflected in dividends purchasing additional credits; a cash dividend would seem inharmonious with the savings aspect of the plan, especially as dividends would supply a means of offsetting inflation—at least in part. All paid-up credits would be totalled at retirement to supply the benefit. If employee contributions were permitted to supplement the contributions made under private plans, some of the uncertainty introduced by varying contributions could be eliminated if the individual desired to do so. Such action would be stimulated if employee contributions were made tax deductible within specified limits. Or the plan could operate on a unit purchase basis in which the value of the units would vary according to the value and earnings of the fund's investment. This would be similar to the method just described up to retirement; in addition, after retirement it would fluctuate in accordance with fund conditions, hopefully reflecting movements in the cost of living. Perhaps the two methods could be combined as under TIAA and CREE.

I suggest that minimum eligibility requirements would not be appropriate until participation by plans in the clearing house was close to universal. An eligibility test, as under Social Security, is designed to limit payment of benefits to those who work long enough—or, in the case of disability, regularly enough—to establish that they depend upon work for the support of themselves and dependents. So long as significant blocks of employment lay outside the system an eligibility formula would not demonstrate such dependence. And if, voluntary employee contributions were permitted, as seems desirable, the amount of credits would not show work connection, unless such contributions were ignored. Such exclusion would run counter to encouraging retirement saving, the exact opposite of what appears to be desirable.

Meeting the Cash Withdrawal Problem

The clearing house would not serve its purposes if cash withdrawal were permitted, as is now the practice when employees are separated from jobs under contributory plans. It may well be that a clearing house would not be feasible until employees prefer the continuation of their credits to a cash payment of considerably less value. The greater value of the retirement benefit should not be too hard to demonstrate to employees. But until the idea is conveyed and accepted, it will be hard to insist upon benefiting employees against their will. This sort of paternalism is not acceptable in our system. The continuity provided by a clearing house system may help demonstrate to employees how much it is in their interests to leave their own contributions in a plan and thereby gain the benefit of the employer's contribution. The fact that with the clearing house the value of their credits "accompany" them wherever they go may remove any uncertainty that they will realize benefits, a factor which probably now helps discourage non-withdrawal. Many vested credits are too small to warrant leaving them in a plan from either the employee's or employer's point of view. But, if they can increase in value and be added to other credits earned before and after, it becomes worth while for an employee to leave them in a plan. And, of course, the employer is relieved of administrative expense and bother.

Of course, employees would have to understand that contributions (like those under OASDI) are not refundable. The draft Ontario Pension Act (1961) would make all contributions non-refundable, and the proposal recommends itself. All participants in the 1957 discussion of transfer methods conducted by the Institute of Actuaries (Great Britain) seemed agreed that a system of transferability requires a ban upon cash withdrawals by employees. This would limit the diversion of other forms of savings into the Pension Clearing House—it could not become a savings bank with demand deposits plus the option of retirement benefits.

Recognizing that sometimes participants may have urgent needs for cash which their other savings are insufficient to meet, some consideration might be given to limited grounds for borrowing against the contributions made on behalf of an employee. Such an arrangement would be terribly awkward under OASDI; however, as private plans represent supplementary and more voluntary savings, consideration

should be given to such a feature. There would seem little purpose to forcing a participant into charity while he has thousands of dollars to his credit in the clearing house group plan. But the exigencies should be limited to bona fide emergencies. Such availability might make this form of saving more attractive to employees and hence encourage the funding of larger benefits which require larger savings.

Possible Use of OASDI Facilities by Clearing House

A national clearing house—whether public, private, or some combination of public and private—might find it advantageous to use OASDI reporting and record-keeping facilities for which the Social Security Administration would be reimbursed at cost.

Should the clearing house offer interim coverage for individuals and basic coverage for small groups, the simplest arrangement would be for the employer to remit contributions and records for that coverage along with the payroll taxes and records for the F.I.C.A. (Social Security) payroll tax. OASDI has established a well-rationalized, fully operating records system covering almost all employees and the self-employed. It would be rare to find an employee under a private plan who is not at the same time subject to OASDI payroll taxes. If, in the course of decades of operations, millions of employee records required recording by the pension clearing house, it would seem a matter of simple economy to employ the already-established OASDI record-keeping facilities. Individual files would require only the entry of a few coded items to record the private credits. An employee could get either his OASDI or private record, or both, through his Social Security number—which is so repeatedly used by an employee that it is quite well known.

Were the clearing house wholly private, its owners might prefer not to be so closely identified with the Social Security system; others may have misgivings about the use of governmental machinery for a completely private enterprise. However, if using OASDI record-keeping is most economical, then it has a great deal to recommend it. After all, retirement savings are intended for benefits, not administrative and overhead costs. The government has leased facilities to private enterprise before—frequently with a less clear social purpose.

We turn next to consideration of the various private, public, and mixed private-public clearing house arrangements.

Clearing House Ownership and Operation—Alternative Methods

A clearing house could be established and operated: (*a*) wholly by private institutions already operating in the pension field, (*b*) wholly as an agency of the federal government, or (*c*) by some combination of private and public (federal government) institutions.

A wholly private clearing house could be organized and operated by the private institutions now servicing pension needs as a supplement to their present operations. Banks and insurance companies with pension facilities, self-insured plans, and unions are the obvious participants. Or unions could provide the initiative through bargained plans as they already have done in a few industries.

A wholly public clearing house could be organized much as the OASDI and Railroad Retirement programs are, except that it would

be fully funded. The plan funds would be invested in fixed return government bonds or government guaranteed obligations. Or, to improve the return on investments and to approximate the benefit potential of private plans, the government clearing house could invest in both government and private securities.

A government-private institution combination could be based upon federal record-keeping, collection of contributions, and the purchase from private institutions of fixed annuities and investment in deposit administration and bank trusteed funds in an adaptation of the Federal Employees Life Insurance program. Or the federal agency could run all aspects of the plan except investment, which could be administered on a fee basis by a corporation owned and operated by the private pension institutions. Or a joint federal-private venture could be fashioned after the Federal National Mortgage Association (Fannie Mae) or the Telstar corporation.

A WHOLLY PRIVATE CLEARING HOUSE

A private clearing house presents these major organizational questions: (1) How should it be organized (owned and controlled)? (2) Should it operate under state law or under federal law or a federal charter which, perhaps, grants an exclusive right to perform the function?

Ownership and Control

A wholly private clearing house requires the participation of all, or at least the major, insurance companies with annuity business,[32] the more numerous bank-trust companies, and the self-administered plans (e.g., those in the automobile and steel industries), including at least those union-administered plans in the non-craft categories. However, coverage gaps in even the best multi-employer, craft-union plans could make participation in the clearing house advantageous for them as well. Not all participants need have a share of ownership and control. But a prerequisite for a workable system—especially if the clearing house were to provide coverage to employees of small companies—would be the feeling on the part of potential participants that the system was fair and did not favor any particular kind of private plan or group of companies or employees. A combination by any one group to the exclusion or disadvantage of another would be thoroughly undesirable and would be an invitation to corrective legislation.

A private clearing house could be established as a corporation whose shares are available to all groups with an interest in this field. The proportion of ownership available to any group probably should be decided in advance of incorporation, with at least ownership participation available to any institution in the pension field. One possible measure of the percentage available to the respective groups and participants might be the amount of the retirement plan business done. However, that is not the only conceivable measure, for some may have a greater interest in "transients" than others. Perhaps the value of actual or potential vested benefits would be more an appropriate

[32] As of the early 1950's there were only 56 such insurance companies. Kenneth Black, *Group Annuities* (Philadelphia: Univ. of Pennsylvania Press, 1955), Appendix A.

measure. Obviously, the matter is a subject for negotiation and composition by the potential shareholders. I would presume that profits would be expected only from operation of the group plan. While some might suggest that this as well as the transfer operations should be nonprofit, insurance companies and banks could argue that because some of the funds handled would remain in plans they service were it not for the clearing house, they should not be expected to operate the clearing house with no returns. Much of the clearing house coverage might be available only because the clearing house exists; but the private groups—if they operate it—would seem to have a valid claim for their normal reimbursement for their services and enterprise.

Shareholding may well be more pertinent to participation in profits than formulation of policy, because the major policies and methods of the clearing house may have to be decided in advance of its establishment in order to assure participation by the necessary groups. Employee coverage by trusteed plans is about three times that of insured plans. Within each group there are competing enterprises and methods. In order to approach universality for the clearing house system, without compulsion, the adherence of participants will have to be induced. And near-universal participation (I assume that you cannot please everyone) can be induced only if minority, or potential minority, groups are given assurance that their interests will not be submerged by the majority or a potential majority of other classes of plans and interests.

In short, the bylaws of the corporation, or a related stockholders' agreement, would be much like a treaty providing not merely for the usual corporate powers and procedures but possibly defining, in advance, the principal policies and methods of the institution itself. Provision must be made for amendments to the underlying agreement and the possible reallocation of shares and the power to select designated officials; of course, any amendment raises the problem either of deadlock or basic alteration in the distribution of power which might prove unacceptable. But an amendment formula should be possible and amendments may be so obviously beneficial as to pose no difficulty in fact.

Difficult as the assignment sounds, private institutions, impelled by common interests and the potential competition of other, perhaps less acceptable methods, should be able to agree upon a workable framework. If the advance solution of *all* problems were a prerequisite of new institutions, there never would be any. Indeed, one advantage of an all-private scheme is that its legislative implementation would probably be speedier than any public or partially public program; it therefore may be the more feasible alternative.

If, as I assume to be quite possible, a clearing house arrangement were agreed upon by the private institutions with a direct interest, there remains the questions of what would be required in the way of public authorization and control, and what governmental authority should be exercised.

Public controls: State or Federal?

The establishment and operation of a clearing house performing only transfer functions would require no more than the amendment

of some state laws to permit insurance companies and banks to purchase and own the shares of such a corporation.

However, the organization and supervision of a clearing house providing some form of group coverage entail more substantial problems of protection for participating interests and covered employees.

Statutory authorization for the operation of the clearing house would probably be required, inasmuch as its functions fall at least partially within domains presently regulated by statute (insurance, corporate trusteeship, and possibly the issuance of securities) but do not correspond to any of the categories sufficiently to operate pursuant to any one set of such statutory regulations. Moreover, in many jurisdictions, if not most, corporate trustees and insurance companies would be either prohibited or limited in their authority to purchase shares of the clearing house.

There are four possible devices for authorizing and controlling the operation of a clearing house:

1. A state statute authorizing the establishment of a clearing house and defining conditions for its operation and participation in it.
2. An authorizing state statute supplemented with regulation by an existing or new state agency.
3. A federal statute authorizing establishment of a clearing house and defining the conditions for its operation and participation in it.
4. Such a federal statute supplemental with regulation by a federal agency.

Regulation of insurance companies and corporate trustees traditionally has been the domain of the states. When the Supreme Court held that insurance operations in some instances constitute interstate commerce, Congress quickly responded with the McCarran Act which reconfirmed state regulatory authority and declared that a federal statute is to be applicable to "the business of insurance" only if it specifies that it is.[33] While the federal government has legislated and regulated in the field of banking, it has not been dominant in the affairs of corporate trustees. A prima facie case is made for state interest.

Two major difficulties could be encountered with a clearing house regulated by the states. That there should not be a multiplicity of clearing house systems seems too clear to require exposition. How then can the 50 states legislate compatibly on *one* clearing house to operate throughout the country? The mere statement of the question implies that where all states have an interest in one institution (not merely a class of activity), federal action is indicated. Indeed, the need for institutions and laws to advance interests of nationwide scope was the very thing which called the Union into being. Additionally, the expressed need for even-handed treatment among the various interest groups may not be readily forthcoming in some states where either the insurance or the banking industry enjoys economic and political predominance over the other.

However, should all the interested groups join in the proposal for a clearing house plan based upon state regulation, it might be possible to obtain compatible legislation and regulation in the states with the major interests and the greatest number of employees under plans,

[33] 15 U.S.C. 1011.

so that the states with lesser interest might follow their lead. Although the states legislating in the welfare and pension plan disclosure field have not acted uniformly, to the chagrin of companies with multi-state plans, a clearing house, as *one institution*, might fare better; but I would not be too sanguine about the possibility.

If such near-unanimity is not achieved, the federal government could provide the unifying factor by authorizing one clearing house corporation. Legislation should protect access to participation by all interested groups and, if necessary, set the proportions of participation—preferably on a basis acceptable to the potential participants. Indeed such acceptability would seem to be essential.

All profit-making enterprises in the field will have a double interest: to participate as fully as possible in the new venture and, perhaps primarily, to minimize the competition from it. From the employee point of view, if the clearing house is to do an effective job of providing interim coverage for employees between jobs with plan coverage and provide basic coverage for small groups, its rates must be low and its conditions generous. Rates and conditions of coverage are the areas of competition and the areas where the interest of producer and consumer diverge and, therefore, are the traditional areas of public regulation.

What is an appropriate federal agency to superintend rates and operations? The federal government has little experience in the area. Would this one program warrant a new agency? Would such an agency have enough to do to warrant its establishment and sufficient funds to recruit first-rate personnel? Some undoubtedly would regard such an agency as a foot in the door for federal regulation of insurance, although there certainly has been no clamor for such federal action.

While there has been little criticism of state regulatory practice in regard to financial practices of insurance companies, there has been serious question as to how effective rate supervision has been.[34] Certainly in other fields—e.g., natural gas—the federal rate-making procedure and agency have been distinguished more by first-rate litigation than by first-rate rate setting.

A single, all-private clearing house system, whether authorized by state or federal legislation, might require some absolution from the antitrust laws if, as it should to do its job, it exercises virtually a monopoly in its own area. As noted, the McCarran Act sought to remove the applicability of the Sherman and Clayton Acts to the "business of insurance" and in the process declared the primacy of state regulation. However, the participation of bank-trust companies and the use of non-insurance devices, some of which the trust companies are bound to insist upon, might remove the private clearing house from the realm of "insurance." Almost certainly it would not be the kind of insurance which has traditionally been the subject of state regulation. The strong probability is that federal legislation absolving a private clearing house from the limitations of the federal antitrust laws or limiting their application would be possible only if federal restraints to protect employee interests were imposed.

Perhaps the foregoing raises more questions than it answers. None of the questions, however, seem unanswerable. They present problems, not barriers. The problems may prove easier or harder to solve than

[34] *E.g.*, Note, "State Supervision over Insurance Rate-Making Combinations Under the McCarran Act," 60 *Yale L. J.* 160 (1951).

those presented by other alternative methods. As the answers emerge, they may appear more or less satisfactory than the answers given to the questions presented by other clearing house devices.

Clearing House Participation—Questions of Legal Limitations and Authority Under State Law

A clearing house composed of private financial institutions and not organized pursuant to federal authorizing legislation would have to conform to state law. In order to "do business" in states other than that of its incorporation it would also have to qualify under the laws of such other states. The question of how such an institution would be categorized, whether as a trust company, an insurance company, or an investment company, should not detain us very long. The strong likelihood is that such a new and special institution (if composed of both trust and insurance companies and possibly others) would require new and specially tailored legislation. When CREF (College Retirement Equities Fund) was established to provide variable annuities in association with TIAA (Teachers Insurance and Annuity Association), legislation tailored to its needs was enacted by the New York State Legislature.

Whether trust companies, insurance companies, and self-insured trustees could participate in the operation and profits of a clearing house with (and very likely even without) investment functions, whether public or private, would depend upon state statutory provisions. Self-insuring trustees are not limited in their powers to invest and purchase shares. If the clearing house were a corporation issuing shares, a self-insurer could purchase such shares and participate in the operation and profits of the clearing house according to its bylaws. In most states insurance companies are limited in their investments; and stock purchases are either prohibited or permitted within narrowly defined limits. Investment in equities (stock) is permitted in limited amounts in 33 states and the District of Columbia. In addition, some 25 states (some not among those in the preceding category) permit a limited percentage of assets or surplus to be invested without limitation as to type; these are called "leeway investments."[35] Thus insurance companies in the annuity and deposit administration field should, for the most part, be able to purchase shares of the clearing house even without additional authorizing legislation. Some jurisdictions might require new legislation.

Bank-trust companies are in a different situation. Their investment funds are held directly on behalf of the beneficiaries of the trusts administered under the directions established by the donors or in pools for such trusts. Unlike insurance companies, the funds they invest are not their own. Bank-trust companies are permitted to purchase stock as trustees, but generally are not permitted to purchase and own shares for their own profit.[36] Exceptions are for salaries in safe deposit companies, the Federal Reserve Bank, Federal Deposit Insurance Corporation, and similar agencies.[37] Thus, it would seem

[35] The information in this paragraph is presented in somewhat more detail in Edwin Patterson, *Legal Protection of Private Pension Expectations* (Homewood, Ill.: Richard D. Irwin, Inc., 1960), pp. 146–152.

[36] E.g., Annotated California Code, Financial, § 761; Connecticut General Statutes Annotated, Title 36—no direct prohibition, but exclusive permissive provisions—§ 57, 86, and 96; N.Y. State Banking Law, § 97 subd. 5 (1961 Supp.).

[37] E.g., Annotated California Code, Financial, §§ 754, 755, 756, 758; Connecticut G. S. A., § 36–57; N.Y. State Banking Laws § 97.

that specific state legislation or federal action in the case of national banks probably would be required to authorize the purchase of stock of a pension clearing house corporation by trust companies. If banks generally wanted to participate, and such a desire might well be a condition of federal legislation establishing the plan and *would* be a condition of a wholly private undertaking, there would seem to be no serious objection to such legislation. The same may be said of any additional authorizing legislation for insurance companies in states where there is no authority to purchase clearing house stocks. In both cases, once a few institutions took the lead, competitive considerations would probably induce at least the major institutions in the field to follow suit and to obtain enabling legislation.

A Union-Operated Clearing House

Unions are in a position to take the initiative in providing clearing house arrangements. In essence this is what some of them have done in negotiating multiemployer agreements which provide for accumulation of all pension credits in multiemployer groups without the requirement of adherence to any one employer. Industry-wide and area-wide multiemployer plans are a form of clearing house which meets some of the problems of "normal" turnover and the other hazards to continuity of employment. But, they do not meet the whole problem, especially where the job opportunities in the units covered are shrinking. They do not meet the needs of those who cannot continue in the same industry because of injury and debility or family considerations. They do not meet the needs of workers whose skills are useful in more than one industry. As automation reaches broader areas of industry, commerce, and service trades, "industry" classification may become less and less significant, and jobs shifts across industry lines, already common, may be expected to increase.

Unions may find that if they can offer transferability of pension credits they will perform an important function at a time when their employee appeal reportedly has been on the wane.

Of course, they could negotiate individual agreements with transfer plug and socket arrangements. Until the sockets become numerous and well known, this may not have great appeal. A clearing house arrangement would be more dramatic evidence of transferability, especially if it provided continued "coverage" when a worker did not have a job under a plan or was unemployed. The Machinists have established a multi-employer plan primarily designated to make pension coverage feasible for employees of small companies. However, one may question whether unions can muster sufficient unity of purpose to achieve transfer rights throughout all or a large segment of organized industry.

But, if all *negotiated* plans had transfer rights provisions the arrangement would still omit at least half of those under plans. Labor organizations might reply, "Let the rest join unions." Others may find this less than a complete answer.

Conceivably unions could be first in the field with a clearing house and might stimulate interest in the institution among employees and non-unionized employers. They could take the lead here as they have, to some extent, with plans in general.

A PUBLIC (FEDERAL GOVERNMENT) PLAN

Before exploring the possible methods of operating a national clearing house by the federal government, some comments are in order as to the general desirability of federal agency participation in such an undertaking; some apply equally to the federal-private combinations discussed subsequently.

Advantages of Federal Participation

In the first place, in the OASDI system the federal government already has the operating procedures for collecting and keeping records of practically all the employed and self-employed. Those procedures are fully rationalized, fully functioning, efficient, and cheap. Employers already report employee earnings and remit payroll taxes to the Internal Revenue Service, which transfers equivalent amounts to the credit of OASDI. To duplicate any major part of this system would seem rather wasteful. Of course, if only a small percentage of employees under OASDI were involved, the use of the OASDI system would be questionable. Probably the breaking point for economic operation could be readily ascertained; and if, taking into account the convenience of the clearing house, the potential use of the clearing house might be expected to reach the break-even point, serious consideration should be given to using the public facilities.

In addition, the federal government could supply the assurance of plan permanence and identity and fund sufficiency that are lacking in vested credits afforded by private undertakings. Perhaps, too, it would be easier for the federal government to achieve universality (with permanence) than a private consortium composed of hundreds of competing institutions. Universality might be a condition of obtaining a sufficiently large and diversified group to operate a sound system.

As a practical matter, the financial institutions which operate in these fields might, probably would, resist a government enterprise which threatens to be a competitor for their usual business. Some of the vested credits handled by the Pension Clearing House would be those otherwise administered by insurance companies and trust companies (as well as some large self-insurers). To some extent, probably increasingly so, clearing house group plan credits would represent "new" business which under present practices are too costly or too complicated to be feasible.

Moreover, as federal participation would be on a non-profit basis, more of the funds allocated to pension purposes could be translated into benefits.

Three major objections may be interposed to a federal Pension Clearing House providing coverage for separated employees and basic coverage for small groups: (1) government voluntary annuity programs abroad have failed; (2) there is no demand for either type of coverage; (3) such a program, particularly for small group coverage, would be unacceptable to private institutions as unfair governmental competition. Let us examine each one.

Wherever the sale of annuities to private individuals by governments has been undertaken it has failed.[38] Public interest was slight

[38] For a brief summary of such attempts see Henry Steinhaus, *Financing Old Age* (New York: Committee for Economic Development, 1948), pp. 40–41.

and concentrated among the more well-to-do, contrary to the purposes of the programs, but it must be observed that these programs all predate the modern pension movement; indeed, they occurred before World War I. One cannot rely upon experience in other places at other times under quite different conditions as an index of present and future needs and desires in our old-age-security-conscious society. In 1935, a proposed domestic program of government-offered annuities, proposed as part of the Social Security Act, was defeated primarily because of the opposition of the insurance industry and unpromising experience abroad.[39] Even at that time the plan was favored by the president of the Equitable Life Insurance Company as a means of stimulating interest in pensions.[40] Conditions then were so different that this too is a dubious precedent.

Moreover, while individual interest or initiative called for by such programs might be slight, initiative on behalf of small groups (up to several hundred employees) may be much stronger and far easier to translate into action. Employers of small groups, who now find plans prohibitively expensive and for whose employees such plans are of questionable value, might desire clearing house coverage for their employees so as to be competitive with other employers, and also to obtain coverage for stockholder-employees and officers.

Much of the pension coverage afforded by the clearing house could not be provided by insurance and trust companies. Clearing house activity might actually expand the private market, as many contend the OASDI program already has.

Finally, opposition from private institutions might be entirely absent if they could participate gainfully in the clearing house operations.

What follows is a description of the types of wholly federal agencies and federal-private combinations which could operate the clearing house and a discussion of their merits, demerits, and the questions they present for future resolution.

Investment limited to government obligations

The Old Age Survivors Trust Fund and its cousin, the Disability Insurance Fund; the National Service Life Insurance Fund; the Civil Service Retirement Fund; the Railroad Retirement Fund all are authorized to invest their monies in federal government long-term securities. Some of them also are permitted to invest in government guaranteed obligation. But they may not make other investments. These authorized "investments" provide modest earnings with maximum—indeed, complete—security for principal; so long as the federal government is solvent, the principal is secure and income is assured. However, the earnings on these obligations sometimes have been lower than government short-term borrowings, the obligations of other governmental units, and, especially in "good times," the yield on private investments.

Exemption from state and local taxation is one incentive for private investment in government obligations but is irrelevant and unnecessary to a federal agency. Yet this advantage is one factor that makes

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[39] Wilbur Cohen, *Retirement Policies Under Social Security* (Berkeley and Los Angeles: Univ. of California, 1957), p. 4: Paul Douglas, *Social Security in the United States* (New York: McGraw-Hill, 1936), pp. 103, 116.

[40] Douglas, *op. cit.* p. 116.

government bonds marketable with a lower rate of interest than private offerings.

The Advisory Council on Social Security Financing recommended improvements for OASDI earning power in 1959[41] which were adopted in the 1960 amendments. The major gain was achieved by permitting purchase of government obligations *either* at current interest rates or at the rate of the average of long-term issues outstanding, whereas formerly the latter rate was mandatory. The current rate may be the market rather than the coupon issue rate.[42] However, these improvements do not overcome the built-in "discount" for immunity from state and local taxation and will not increase fund earning power up to that of private funds not so restricted.

The investing federal agency has no real alternatives and no bargaining power, hence interest rates may be lower than what is available on other borrowings. This is good for the government; it keeps interest costs on the federal debt down. In turn, low interest costs are good for the general taxpayer (individual and corporate). But one can at least raise the question whether the employees whose savings are so invested have been subsidizing the rest of the taxpayers of the country and losing part of the full earning power of their funds. In return, however, those covered by these programs are receiving a guarantee, explicit or implicit, that the federal government stands behind the benefits afforded by the program. No such guarantee would seem to be in order in a supplemental voluntary pension system operated on private insurance principles. Perhaps more importantly, the benefits of the OASDI and some other governmental programs are not heavily dependent upon fund earnings as a source of money with which to pay benefits. In contrast, private plans—after which the clearing house group plan would be patterned—rely upon fund earnings as a major source of benefits. Hence, in such a group plan earnings should be as high as possible consistent with protection of principal.

Investment in Both Government and Private Securities Permitted

If a government fund were operated by a group of experienced investors, empowered to invest in *all* kinds of securities and investments, probably a portfolio could be devised consisting of federal bonds and insured mortgages, state and local government obligations, industrial bonds, *and* private equities (stocks) so as to attain both security of principal and a higher rate of earnings than is now realized on the government's retirement trust funds. If a government clearing house fund were given power to invest in all kinds of securities and investments the risks of both favorable and unfavorable earnings experience would be borne by the employee participants unless a guarantee of interest, even at a fairly low level, were given legislatively. The Railroad Retirement system provides for a guarantee of 3%. It is dubious that Congress would be favorably disposed to do this for an optional system in which middle and high income personnel could participate and from which some employees, eligible for

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[41] "Financing Old Age, Survivors, and Disability Insurance: Report of the Advisory Committee on Social Security Financing," 22 *Soc. Sec. Bull.* (No. 2) 3 at pp. 9–10 (1959).

[42] 74 Stat. 924 at 993, Pub. L. 778, 86th Cong. 2d Sess., Sec. 701. This authority is given to the Managing Trustee, who is the Secretary of the Treasury. He is authorized to borrow at current rates "only where he determines [that it] is in the public interest." In other words, he may consider factors other than the earnings of the fund.

OASDI coverage, are excluded by the present rules on "integration." A guarantee for such a fund, not available to employees covered by ordinary private plans, probably would be unacceptable because it would be a potential obligation of all the taxpayers in favor of a limited group which already enjoys tax advantages for its savings.

Of course, the element of risk inherent in private investment could be limited in the same way that insurance companies are limited to certain kinds of high grade securities (which may have a lower yield than less renowned securities), with a specified percentage allowed for investment in common stocks or "leeway investments." Without evaluating the desirability of legal limits upon the investment of private insurance company funds, the arrangement does not seem, to me at least, readily exportable to a government fund. Legal directions and limitations specifying minimum and maximum percentages of kinds of investments would defeat, to a considerable extent, the value of investment by such a committee guided by expert judgment as to what is sound and advantageous at any given time under the specific conditions pertaining. Even the best drafted statute could not anticipate the multifarious combinations of circumstances which would warrant buying or selling certain kinds of investments. A responsible committee or board would be mindful of the desirability of combining security with earnings and not unduly sacrificing either to gain the other. That is the task of an investment committee.

Nor is a government agency the same as a private corporation. In maturity, the agency would have greater resources, unlimited access to government bonds at either the average interest rate or the current interest rates (if in no worse a position than OASDI), and under no necessity of showing a profit. In all or most of these respects it is free of the pressures to which private institutions are subject to maximize income. And, in this area, it would be operating as a monopoly and solely in the interests of future beneficiaries, thereby being free of some pressures to show high returns. For all of these reasons, limitations on investment designed to promote the security of policyholder and depositor funds are not necessary for the government clearing house.

The desirability of maximizing income by investing funds in productive private enterprise does not derive from the fact that the OASDI fund (and those that are patterned after it), as some contend, "represents nothing more than a dead weight of debt" and has "already been spent, chiefly if not entirely, on non-productive projects." [43] The OASDI funds are invested in government bonds, which represent debt for governmental expenditures, practically all non-productive in the manufacturing sense. However, most of these expenditures are essential to the protection and operation of the private economy and so may properly be regarded as national overhead without which our directly productive facilities providing goods and services would function poorly, erratically, or not at all. And, of course, there are private enterprises whose output of goods and services are reflected in gross national product but satisfy only the most marginal human needs and may, in fact, be deleterious. Their multiplication will not expand the

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[43] E.g., see Allen Rucker, "Economic Challenge of Longevity," 32 *Harvard Business Review* (No. 12) 94 at 98 (1954).

economy's ability to support a larger dependent population. Clearly, parts of both the public and private sectors are socially productive and promote an expanding economy and others are not.

And investment of retirement trust funds does not represent an amount not available for private investment. For, to the extent that governmental trust funds meet the bond sale needs of the federal government, private funds are not drawn upon for that purpose. Instead private funds must secure some private investment, a rather direct contribution to "productive" facilities.

Originally I believed that the often superior dollar yield of private investment made a private investment scheme markedly superior to a clearing house fund limited to governments. Private equity investment, it seemed at first, was the only way to ensure that "savings" would go into expanding capacity out of which the needs of the elderly could be met. The balance no longer seems so clear to me. The economy since World War II has shown remarkable ability to grow; unprecedented increases in productive capacity made possible by private investment are evidence. Alas, some of the capacity goes unused for lack of buyers. New or enlarged sources of investment capital do not seem to be the critical element to achieve growth, although there is more than one opinion on this subject.

Public services—education, hospitals, medical care—may be equally important to balanced growth. Government bonds purchased by a trust fund for a supplemental pension system may be useful to the economy as a whole and in providing an expanding base for a larger "dependent" population. The public should not expect a subsidy from these retirement savings and should be prepared to pay interest on such bonds equal to the value of the funds borrowed.

Some may question, as I do, the desirability of government officials operating in the private financial market, especially if the funds at their disposal are large. On political grounds, it does not seem desirable for a government agency to have the power of a multi-billion dollar fund hanging over the investment market, although in view of the government's vast borrowing operations the objection may have become academic. But the government's present powers to borrow, spend and invest are not concentrated upon financial dealings in general but are channeled by specific programs to meet specific needs, such as fund raising, defense procurement or housing. The objectives of such programs give them their shape; their financial aspects are generally contained by substantive purpose and expressed policies. In contrast, the objective of the Pension Clearing House roughly would be those of the traditional investor—security of principal balanced with maximization of income in the interests of "investors." The clearing house would not be confined, as most government units are, to a program to which the financial powers are merely incidental; its financial operations would be central. Although some federal agencies, e.g., TVA, presently manage their own pension systems, including the investment function, their systems are miniscule compared to the potential of a federal Pension Clearing House.

The objections to broad investment powers in private as well as government securities on the part of a government clearing house could be met by assuring a substantial measure of participation, especially in financial operations, by the institutions which presently perform

these tasks in the private economy; the insurance companies, bank trust companies, and "self-insured" trusts. Such arrangements will now be considered.

FEDERAL-PRIVATE CLEARING HOUSE ARRANGEMENTS

A pension clearing house offering group coverage to separated workers and employees of small companies could operate under any number of public agency-private institution combinations.

Federal Clearing House Purchasing "Coverage" from Private Institutions

In a combined federal-private arrangement, the federal clearing house could operate transfer facilities and a group plan. It could invest portions of its accumulated funds in deposit administration plans and with bank-trust companies and purchase paid-up annuities for those retiring—much as some smaller funds use "split funding." A major difficulty with the purchase of paid-up insurance for active plan participants would be the frequent—indeed, constant—separation of short-term participants moving to individual company plans. However, insurance companies could participate on a deposit administration basis, with a guaranteed rate of earnings which would balance investments with corporate trustees without such an assurance. In this fashion, the traditional private institutions would handle the investment of the funds on a contract basis and some annuities might be purchased only when the participant retired, although some might prefer drawing benefits directly from the fund on a variable annuity basis. Whether the government agency could deal effectively and intelligently with more than a few insurance companies and banks is an open question. Presumably the considerable size of the clearing house funds would enable it to obtain favorable terms, although the size might also interfere with a high degree of selectivity. Competition might operate to give the clearing house maximum returns. Very possibly the business would be concentrated among the largest carriers and banks, to the exclusion of the smaller private institutions.

In addition, the large self-insurers would be excluded from any direct participation in clearing house operations or arrangements, unless an advisory group were formed in which they were adequately represented. Presumably the large self-insurers would have direct access to clearing house officials, to say nothing of executive and Congressional officials, adequate to register their needs and opinions effectively. Conceivably, too, the investment program might be used for political purposes.

Since the mid-1950's the Civil Service Commission has operated the Federal Employees Life Insurance program by purchasing group coverage for most federal government civilian employees from a few large private companies. The coverage and benefits are standardized, the rates are low, and judging by the lack of criticism of the program from any quarter, this novel program may be regarded as a success.

In sum, operations under the Federal Employees Life Insurance Act provides something of a precedent for the practicality of a federal agency collecting funds and keeping records while purchasing group pension coverage from insurance companies and bank trustees.

Federal Clearing House Purchasing Investment Services From a Consortium of Private Institutions

The clearing house could assume all responsibility except fund management, which is, perhaps, closer to the foregoing purchase arrangement than it sounds.

In effect, the federal clearing house would entrust its funds to a Pension Finance Corporation (PFC I shall call it, a rather humble name) which would receive fees for managing the fund. The PFC would have authority to invest in federal securities and guaranteed investments, state and local obligations, *and* private obligations and securities. Such an arrangement would combine many of the advantages of government administration and private investment. The arrangement would overcome the objection that a potentially multi-billion dollar fund managed by government officials would give too much financial and political power to the federal government.

But there are other problems. What control could be exercised over the PFC? If it enjoys a monopoly, the clearing house's bargaining power on fees and investment policy might be slight. If lack of bargaining strength by government agencies has been a problem in dealings with private companies with great market control in the vast procurement efforts of the past two decades, it has not been a matter of much comment or public concern (other than in the field of electrical equipment—where the problem was not bargaining power).

In any event, the management fee schedule could be set by statute; such an approach would substitute Congressional control for executive negotiation. Congress may lack "expertise" on questions such as fees for investment services and be susceptible to special-interest tugs of war that have characterized interest rates on government-insured loans. In this particular area, the realm of potential disagreement seems limited. The investment fees probably would be lower than those paid by companies to corporate trustees and the "loading" in deposit administration plans because of the large fund and the favored position of the one group dealing with the government. Obviously the system would not work satisfactorily without fees adequate to provide a profit to the enterprises participating in, or owning, the PFC.

PFC would be composed of those private groups desiring and able to participate, presumably insurance and bank-trust companies; and perhaps self-insurers and unions with pension funds also may desire ownership shares. A corporate form of organization under a federal charter specifically providing the PFC's power and freeing it from the investment limitations imposed upon insurance companies and bank-trust companies would seem desirable. As already indicated, the Commission would receive a management fee for investing the clearing house reserve funds—set by statute or by negotiation. The PFC would require some working capital for rent, for salaries for its investment committee, supporting experts, actuaries, and clerical and record-keeping staff, and for other operating expenses. The capital requirements would be relatively small so that the tangible value underlying Commission shares would be relatively small. Therefore, no immediate purpose may be served by setting a high price upon Commission shares unless a source of revenue for its long-term administrative and research costs is desired. In that case the price of

the shares could be set at a fairly substantial figure, which also might have the effect of distributing ownership and control of the PFC in some rough proportion to the financial strength of the participating institutions. In all likelihood, the price of shares—unless it was high and the shares numerous—would not have such an effect and some other method of determining participation would have to be devised. Shares up to a low limit could be available to *all* financial institutions meeting certain criteria—the most meaningful of which would be their actual involvement in pension plans. Unlike the Federal Employees Life Insurance Act arrangement, the participating institutions would not provide services or policies of their own so that their size and capability are not relevant for that purpose. But the size of an institution's pension business might be considered relevant to the size of its role in the PFC.

The most important "asset" of the Commission would be the expertise of its personnel. That expertise, developed primarily in private finance, would, of course, carry the possibility of "conflict of interest." The problem of abuse does not stem from the natural cupidity of mankind but rather from the biases, attitudes, and loyalties developed in private financial institutions.

I assume that the finance committee and managerial groups would be chosen, in effect, by large stockholders, presumably banks, insurance companies, large plants, and possibly unions. They would be, by and large, men and women with experience in banking, insurance, and security investment. Assume further that they are required to sever all employment connections and devote themselves solely to the fund management. (What would become of *their* private pension credits? Answer: Transfer them to the clearing house!) Would they not operate nonetheless as representatives of the institutions from which they come, at least on occasion and if not consciously, unconsciously? Moreover, would not many expect to return whence they came or some place like it? This influence might infringe upon total objectivity.

Alas, we have tolerated worse conflicts of interest, especially in war and emergency situations in organizations such as OPA and the Office of Defense Mobilization, where experts were "on leave" from the industries they controlled or whose tax "write-offs" they acted upon. At the least, complete severance of employment and a ban upon arrangements for re-employment while still employed by PFC should be required. This may be all that can be accomplished by direct prohibition.

In addition, the government clearing house should have complete access to the records of the PFC, including the minutes of meetings at which investment decisions are made. It should have access to confidential information and the right to conduct formal inquiries upon formal charges of alleged violation of trust responsibilities. It may also be that the possible conflicting biases and interests within the PFC would offset one another.

Finally, most talented men and women probably have enough pride of expertise and are not so dependent upon one employer as to subordinate the interests of the undertaking to those of their former or possibly future employer. There are risks in all undertakings. And the particular conflict of interest problem here may be less difficult than it has been in many other situations, provided that it is recognized and dealt with in advance.

Some other problems of such an arrangement are dealt with at the conclusion of this section because they involve several of the arrangements under discussion.

A Federal-Private Corporation

Except for the novel Telstar satellite corporation, the federal government has yet to enter into active ownership with private groups in a formal enterprise, although not infrequently it has taken much of the risks of private undertakings without participating in the profits.

The Federal National Mortgage Association is a federally chartered corporation in which both the United States and private enterprises own stock. Although it is contemplated that one day FNMA will be privately owned and operated, the United States has owned the preponderant number of shares and dominated the mortgage purchasing operations of the Association.[44] It cannot be said that FNMA provides a precedent for an undertaking jointly owned by the United States and private groups in which the interests and authority of both are nearly equal. This is not said in criticism of FNMA, whose operations should be judged in terms of the program it was designed to foster. As an experiment in joint federal-private ownership and operation, it probably should be regarded as not yet mature.

Perhaps a joint operation can be devised for clearing house purposes. Since no large amounts of capital would have to be provided by government for the pension undertaking, division of authority would not be based on the amount of Congressional appropriation, as is the case with FNMA. Instead the distribution of authority would be made legislatively on a "philosophical" basis: What portion of power should government and private interests have? What system of checks and balances does not threaten to end in deadlock and yet provide public and private representatives with sufficient power to protect legitimate interests? To me at least, this arrangement contains many insoluble problems and offers no clear advantages over the alternative arrangements. Others may be able to devise a joint undertaking that would serve the purposes of low-cost, universal credits connecting private plans, in which the government provides its reporting and record-keeping facilities and contributes to policy formulation while private interests have enough incentive to participate and sufficient control of investment policy to prevent its use for political purposes. Perhaps the Telstar experiment will provide some answers. There the federal government and private interests are collaborating; however, the government is able to establish its control over the corporation should it so desire, and the private interests are dependent upon space vehicle launching facilities of the government. Because a pension clearing house would lack such government control of key facilities, it is doubtful that the Telstar corporation can be regarded as a precedent, although it may provide us with some lessons.

Problems of Ownership and Voting of Shares in Private Corporations

The ownership and voting of private shares purchased by a federally chartered private or public-private pension venture presents problems,

[44] For a fairly detailed account of Fannie Mae and her predecessor ("its" seems ungallant), see Charles Haar, *Federal Credit and Private Housing* (New York: McGraw-Hill, 1960).

principally: would the funds available for private investment represent too great a concentration of investment power and voting power in the affairs of private corporations?

Over an extended period, the clearing house might accumulate substantial funds and, hence, investments. In the case of a Pension Finance Corporation the Corporation would have the authority to invest; it would have to be decided whether it would purchase and hold the shares in trust for the clearing house or only advise, albeit with almost binding force, the clearing house to purchase, hold, and sell the shares for its account. Which entity would vote the shares? If the PFC were established to keep a government agency out of the private economy to the extent possible, it would seem to follow that the governmental clearing house should not vote the shares. Should the PFC? Perhaps the shares might not be voted; but voting might be pertinent to the continued soundness of the investment, hence such an alternative does not seem prudent. Establishing a third group, to vote the shares after consultation with PFC, would partially divorce the investment power from the power to vote the shares purchased and would reduce the effects of the concentration. But such a separation of functions might be awkward and not operationally sound because the two functions might often be interdependent.

How could the voting group be selected? Representatives of employer, employee, and union groups are an obvious beginning. Each would balance the other where the employer-union, employer-employee relationship is potentially involved. Others with knowledge of special fields would be useful on such a voting board. There need not be tripartitism of the kind employed in the National War Labor Board, the Wage Stabilization Board, and some *ad hoc* groups in the labor-management field, because the third force would not be "public members" without allegiances to either side. Rather the voting group could be made up in part of specialists in areas pertinent to the limited functions of the stock voting board. Such a board would not seem necessary before the fund involved became quite substantial. Up to that point (whatever it may be deemed to be) the PFC could vote the shares and an Advisory Council and the Clearing House itself would probably provide sufficient back seat driving and a governmental brake.

How great a concentration of economic power might there be in any of the groups discussed? The total resources of private group pension plans are estimated to be in the order of $60 billion—some of it invested in government bonds. Only a very small portion of that amount is dedicated to funding vested deferred benefits. Of course, both totals will grow, and funds for vested rights may grow at a faster rate. With the encouragement of a clearing house, the total and the vested portion may grow even more rapidly than otherwise. In terms of our economy even several billion dollars in the hands of one corporation (especially one owned in common by competing interests) hardly represents a threat of too great economic concentration. For example, the assets of the Metropolitan Life Insurance Company alone were over $17 billion in 1959. The clearing house's PFC's "portfolio" would be very much like that of an insurance company or bank trustee with large portions in public and private debt securities and a portion in

equities. It would be possibly decades before the amount of stock holdings would become significant, especially in comparison to the holdings of individual enterprises such as the Metropolitan. At any rate, we presently permit similarly large private concentrations of wealth and while they may make us nervous we prefer them to governmental control. Another large owner should not be too great a bother.

Adequate Representation for Interest Groups in an All Public or Public-Private Clearing House

An advisory committee composed of government, "public," employer, union, insurance, bank, self-insured, and possibly consultant personnel might be capable of exercising some influence upon any of the clearing house arrangements in which government has a part. An advisory committee need not be without character and effect, especially if the public members command respect.[45] Interest group representatives often are the "big names" who can not possibly attend the meetings of all the public advisory groups of which they are members. Their representatives, though not speaking with the entire authority of their principals, do have access to the inner workings of both the agency being "advised" and their own organization. Informed and attentive observers so placed can exercise influence at least indirectly by raising issues intramurally—or if necessary, publicly. Of course, as in any undertaking of our pluralistic system, this does not insure an outcome determined strictly on the formal merits.

That the advisory council device has been deemed useful is indicated by the provision in the 1960 Social Security Act amendments for periodic advisory councils; the council appointed in 1963 is to consider all aspects of the program.

The Outlook for Transfer Values and Clearing House Devices

If the foregoing discussion makes a sufficient case for the propositions that transfer value arrangements and clearing house devices are desirable and that they complement each other, what are the prospects for their adoption in some form?

Any prediction is premature because the problems to which they would be the answers, or palliatives, have not themselves been scrutinized intensively since the advent of the modern pension movement. Any prediction also is premature because transfer values and clearing houses have not been the subject of any extensive commentary in this country.

Since I undertook this study in mid-1959 there have been stirrings of interest in the pension problems posed by turnover, structural unemployment, and changes in employer organization. Until the problems of pension expectations are widely recognized, until there is a strong demand that "something be done about it," *and* until transfer values and specific clearing house proposals are given widespread and serious study, no one can know how they will fare.

The New York Vesting Study, based upon interviews with pension experts representing management, labor, insurance, banks, and con-

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[45] For a generally favorable presentation of the potential contribution of such groups, see Joseph Becker, "Advisory Councils in Employment Security" 12 *Ind. & Lab. Rel. Rev.* 370 (1959).

sultants principally about vesting, with some questions about transfer values and undefined clearing house devices, indicates that we can expect some negative reactions. But I suggest that they were premature opinions about an amorphous proposition, whereas the major details of a scheme can be crucial. As to the transfer values the New York Vesting Study reports:

The objection was in every case that the diversity of actuarial practice with respect to valuation of plans would make the valuation of withdrawal credits in one plan unreal in terms of the valuation procedures used in the other and that all sorts of malpractices in the matter of valuation would thereby be encouraged.[46]

In strong contrast is the discussion based upon an intensive study of transfer values by the British Institute of Actuaries; the three actuaries who conducted the study reported that while there is no uniformity of actuarial opinion as to how transfer values should be derived, a major result of the study was the recognition that such valuation is "practicable." [47] Moreover, they concluded:

It is clear that there is no royal road of simplicity to the assessment of transfer values and cold-storage benefits in privately administered schemes. Whatever methods are adopted, valuation profits and losses are likely to arise, but in relations to the liabilities of the scheme as a whole, they should be relatively unimportant. . . .

Whichever method is used the additional benefits would be payable in the circumstances prescribed by the rules of the scheme, which would be related to the conditions of the new employment. These might be quite different from the conditions of the old employment, for example, in regard to retirement are. Because of differences in the conditions of membership of the two schemes, the amounts of the additional benefits granted in the new scheme might be very different from the member's accured benefits in the old scheme, while remaining their equivalent in value.[48]

While I doubt any great potential for profiteering, there should be safeguards against abuse in establishing transfer values. Under present regulations qualified plans must report any plan amendment to the Internal Revenue Service and in the annual reports required by the Welfare and Pension Plan Disclosure Act. At least the tax authorities and transferring employees would be interested in the formula for computing incoming and outgoing transfer values. Many such provisions would be bargained collectively and only after thorough exploration by experts. Perhaps more importantly, an experienced clearing house administration, whether private or public, could promulgate one set or alternative sets of criteria for appropriate valuation provisions. At the minimum, I suggest, plans and the clearing house should limit transfers to plans which apply identical procedures and valuation methods to both incoming and outgoing transfer values. The self-disciplinary function of such a requirement should be apparent.

The Ontario group of pension experts recommended the establishment of a transfer value arrangement as an adjunct to compulsory

[46] *Op. cit.*, pp. 24–25.

[47] Spratfield, Bacon and Bromfield, *op. cit.*, at "Abstract of the Discussion," p. 202 (The Ontario Second Report, discussed below, is in accord as to the practicality of transfer values.)

[48] *Id.*, p. 187.

vesting. Under the 1963 Ontario law there would be a compulsory private pension scheme for employers with 15 or more employees. Vesting would be compulsory on a graded plan for service after age 30. To conserve credits of separated employees and those earned under plans which become defunct, a Central Pension Agency is to be available to bank transfer values on a voluntary basis. The proposal's major purpose is to provide wage-related retirement benefits with specified minimum standards and benefits. The Ontario plan favored a private clearing house, not otherwise described, which would provide minimum transfer service at *retirement* so as to overcome valuation problems (the pros and cons of this were discussed above) and also to accumulate small vested credits for separated employees. While the Ontario report recognizes the spottiness of small company plans, it makes no proposal for a system of providing basic coverage to this group through the clearing house. Of course, perhaps the greatest difference is that the Ontario system would be compulsory and what I suggest for consideration would be wholly voluntary. It contemplates limited operations for a central agency because of fears that its fund would be too great a concentration of economic power if given a large role. However valid that might be for Ontario, the reasoning seems inapplicable to our situation. Moreover, I believe I have suggested feasible means of checking and balancing that potential power.

Although my alternatives differ markedly from the Canadian proposal, it demonstrates that such an agency has recommended itself to a group of independent experts who were set the problem of how to deal with the pension problems of turnover and vesting. If the scheme goes into operation we may discover that fears expressed about transfer values are unfounded.

Whether clearing house devices will prove useful and acceptable in the United States one cannot foretell. New ideas initially generate friction and resistance. But it is assuredly too early to choose up sides until concrete proposals can be assayed. Until now, none has been put forward in this country, let alone considered on the merits.[49]

With growing disquietude about the resilience of private plans and their adaptability to changing economic conditions, I suggest that transfer values and a clearing house system may be indispensable to their continuation as a major means of providing income in retirement.

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[49] Since the completion of this manuscript an actuarial consultant has endorsed the idea of transfer values and a clearing house to meet the turnover problems of automation. He favors a wholly private arrangement not otherwise described. *The New York Times*, April 22, 1963, p. 29, col. 5.

PUBLIC POLICY AND PRIVATE RETIREMENT PROGRAMS—A SUGGESTION FOR CHANGE

BY PEARL E. CHARLET*

PREFACE

The purpose of this paper is to view the aggregate sources of old-age income in their entirety from four different perspectives:

1. Background and history.
2. Current status.
3. Outlook for the future.
4. An alternative avenue for consideration.

Every society in the history of mankind has been faced with the problem of dealing with its aged members. Solutions have sometimes been radical but have always reflected the needs and conditions of the society that devised them.

In the American society the problem of the aged citizen who becomes economically nonproductive has been dealt with in a number of ways which have reflected the social and economic conditions of the period. The solutions have encompassed both private and public efforts and have included both work-related and nonwork-related approaches,

Nonwork-related solutions:
- Private methods:
  - Private charity, including church, fraternal, and charitable organizations, etc.
  - Family and friends.
- Public methods:
  - Public charity, including the alms-house, local relief agencies, etc.
  - Veterans' pensions.
  - Old-age assistance.

Work-related solutions:
- Private methods:
  - Personal savings.
  - Employers, including work continuation, individual grants, and employee retirement systems.
- Public methods:
  - Old age and survivors' insurance.
  - Public employers, i.e., public employee retirement systems.

Basically, our society accepts the principle that no member should suffer for want of the basic needs of life. When the number of aged persons represented a small proportion of the population, those needs

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which individuals could not provide from their personal savings could be met by comparatively simple methods of public or private charity at the local community level. But as the aged sector grew and the country changed from a rural agricultural society to an urbanized industrial economy, it became necessary to seek more sophisticated solutions to the "unsaved for" needs of old age.

These new solutions were first expressed in employer and trade union attempts to formalize systems of work-related annuity payments for superannuated workers. The second major attempt at new solutions was the action of the Federal Government in enacting social security legislation. This approach also stressed the provision of retirement income from work-related sources; however, the two solutions, the private and the public, utilize different concepts and methodology for implementing the transfer of income from work to the nonproductive years of old age.

Much of the current debate about such aspects of the private pension approach as funding, vesting, portability, etc., is in truth directed to an unspoken questioning of the need for a pluralistic system of retirement income when both private and public systems appear to be directed toward the same goal. Such debate hides the real need for deliberation about the fundamentals of the present two-part system for old age support.

The primary objectives of the two systems are necessarily different. The social security program is concerned with the social need of assuring a basic subsistence level of income for all older citizens. It meets this need to the extent possible through the work-related mechanism of Old Age and Survivors' Insurance; where work-related earnings are nonexistent or inadequate, the need still remains and is met through the Old Age Assistance provisions of the Social Security Act. The fact that Old Age and Survivors' Insurance is related to work earnings may actually be more an "accident" resulting from the need to create acceptance of the program as an insurance system (rather than a need-related welfare program) than a deliberate design by the architects of the System. Certainly, the ultimate benefits received from the System by individuals bear little relationship to their payments into the System, since they are related to the individual's needs as society defines them. The social concept of the System is further exemplified by its utilization of current transfer payments, i.e., payment of benefits from current taxes imposed by the System.

The private pension system is primarily a device for transferring earnings during the working years into income for support in old age. As such, it utilizes the principle of "time transfer payments." This basic function is fulfilled whether the earnings come from the worker after he has earned them, or whether the employer diverts the money from the pay check and channels it into a fund to produce retirement income. An employer need be concerned with social goals only as they relate to the needs of his own work force and can design the program to meet these needs in the most efficient manner. He need not spread available funds to achieve broad social objectives, but can direct them to provide maximum equity within the work group. This equity is achieved by structuring benefits to reflect the worker's period of service or a combination of earnings and service. The private pension plan

deals only with replacement of work-related income—it is precluded by its basic nature from concerning itself with the income problems of the nonworking segment of the population.

Much of the criticism that has been directed at both public and private systems for old age support results from the confusion that arises in trying to adapt social aspirations to an economic device, or vice versa. Each of the major systems has a role to play and a function to perform, and neither system should be measured or judged in terms of the purposes of the other.

The area of criticism most frequently heard relates to tax privileges granted to time transfer payments under private retirement plans without concomitant requirements to satisfy broad social interests. It should be remembered that tax exemption was extended to private retirement plans before the social conscience of the country was expressed in a public system for old age support. The early retirement programs of private employers were in fact the initial step toward expression of what later was recognized as a national social goal, namely the formalizing of old age support systems.

Current discussion of ways to strengthen the private pension movement has focused attention on areas of private plans that should conform to certain broad social criteria as now defined by the public system. There are implications that continuation of the tax deferment privileges extended to private retirement plans more than 40 years ago should be dependent on a shift in emphasis from concern with the needs of a single work group to a broader base of concern for the entire labor force. Suggestions of this kind ignore the fact that private retirement plans perform a secondary function of social significance by virtue of their ability to meet old age income needs over and above the subsistence level for those work groups covered. Arguments for extending the social concern of private plans imply that social objectives are met by spreading available funds to provide a little above the minimum level for many workers, rather than an adequate level for a lesser number. Perhaps the true concern of social thinking should be the extension of the adequacy level of old-age income through the private retirement system.

The most common criticism of the OASI program is that benefit amounts are inadequate. The corollary question, of course, is: "What constitutes an 'adequate' benefit?" or, more precisely, "What is the level of old-age income maintenance that is appropriate for the OASI system to provide?"

Unfortunately, when the original Act was passed the question of benefit adequacy was secondary to the greater concerns of the constitutionality of the bill, its passage through Congress, and the method of financing benefits. In fact, the original schedule of benefits was determined as the actuarial value of the contributions that the designers of the system felt could be imposed without risking rejection by Congress.

The inadequacy of the original benefit schedule is confirmed by the fact that Congress has increased the amount seven times (including one increase prior to the actual payment of benefits) and an eighth increase is likely to be passed by the 90th Congress.

The role of Old Age and Survivors' Insurance was described by the Senate Finance Committee in 1935 as a "system which will pro-

vide something more than merely reasonable subsistence" and by the House Ways and Means Committee in the same year as "a system that would assure support in old age in amounts which will insure not merely subsistence but some of the comforts of life." In 1954 the House Committee referred to "establishing a level of social security benefits which will represent a realistic floor of protection in line with current price and wage levels." Despite these and other definitions of the role of social security which have been expressed since 1935, there has not been any coordinated attempt to translate such expressions into dollars and cents, or even into understandable standards of living, other than the benefit levels that Congress has from time to time enacted.

Certainly, any definition of the role of OASI in providing old age support is complicated by the fact that a single "standard of living" carries different price tags in the various parts of the country, or that any dollar benefit will translate into numerous standards of living. But unless some generally accepted agreement can be reached as to the level of support that OASI should provide, the system will be judged by the standards of income adequacy that can be normally produced by a private system of retirement benefits.

Thus, we find that the private system is criticized for its failure to adhere to the social values of a public system, and the public system is criticized for its failure to produce benefits of an "adequate" amount.

The balance of this paper is devoted to examination of the forces and conditions that shaped our total system of old age support and to consideration of a possibility for future change in the private retirement system to increase its effectiveness.

I. Background and History of Old-Age Income Sources

The evolution of systems for financing old age in the United States has run parallel to the current of social, economic, and political developments. Since today's systems are an outgrowth of past events, a review of old-age income sources in their historical setting should lend perspective to current thinking.

EARLY HISTORY

During the first century of American political life—from the beginning of the Revolution in 1775 to 1875—the economic needs of older citizens were satisfied chiefly by family resources. It must be recognized that the elderly represented a relatively small segment of the population. The incidence of life extending into the seventh decade (the sixties) was not the commonplace rule that it is today. The influx of European immigrants, who typically arrived in youth or early adulthood, tended to weight the population toward youth. Thus the ratio of older citizens was low, and the economic burden of support usually spread over a number of younger family members.

Economic activity during the first century of American history stemmed principally from agriculture—a form of livelihood that lends itself naturally to the retention of aged members within the economic sphere of the farm and its household. The typical farm household in the 18th and 19th centuries included two or more generations of family

members. The older generation was likely to be the owner of the land and household property, while younger members principally supplied labor in return for the livelihood the land provided. As land owners aged, they gradually decreased active participation in the affairs of the farm but remained in the household and shared in the income produced. Where the older member was the landowner, such income represented a return on investment from either his own efforts or from property inherited from earlier generations. Even where the older generation was not in the propertied class, the support of parents in old age was generally the accepted responsibility of children during this period.

In the case of individuals who devoted their active lives to self-employment in a trade or business, the picture was apt to be much the same as that of the aging farmer. There was no question of forced retirement, and the individual usually continued to his business affairs until he chose to turn over the reins to younger family members or he was forced to do so by ill health.

For self-employed workers, both in agriculture and in trade or business, the dominant pattern of the early era was for children to follow in the occupational footsteps of their parents, a system which offered the twofold advantage of providing employment opportunity for the young in an age when little outside demand for workers existed and economic security in the later years for aging parents.

Those older Americans who were not attached to the land or self-employed in their own business looked to somewhat different sources for income maintenance in old age. Those individuals who spent their working lives in the employ of others for wages or salaries had to rely on their own ingenuity and frugality to save for the day when they would be unable to work. Failing financial independence, the aged worker was dependent on the ability and willingness of family members for support, or on the generosity of his employer either to retain him on the payroll in some appropriate capacity after his productive capabilities had diminished or to grant him some modicum of financial assistance as a matter of charity. A scattering of employee relief associations were in existence during this early period and in some cases aged workers received assistance, but there is no evidence that these associations were a significant factor in financing old age. In the absence of any of these forms of support, the impoverished older citizen was faced with the choice of accepting public charity in the poorhouse or poor farm, begging, or starvation.

One other alternative did exist during the period following 1818 for a special group of the population: if the individual had served his country in a military capacity, a pension might be available, or care in a home established for old soldiers of broken fortunes. The veteran's pension was for many years the only public source of old-age assistance with "honor."

The sources of old-age income during this early period reflected the conditions of the era, which was marked by a spirit of strong personal independence, the westward movement of the population, and reliance on agriculture as the principal source of livelihood. Although these were the dominant characteristics of American society, changes began to occur gradually during the latter part of the period which foreshadowed future developments in old-age income resources. These

changes included the beginning of the industrialization of the economy and the migration from rural to urban areas.

The earliest attempts to formalize systems for old age financing emerged toward the end of the 19th century. Interest was concentrated primarily in the railroad and closely allied industries, the reasons being that railroads were the first American companies to employ substantial numbers of workers, and because it was not feasible to continue older workers in positions that might jeopardize the safety of passengers and equipment.

The comments that follow trace the development of today's systems of old-age support by quarter century periods from 1875 to the present.

1875–1899

The final quarter of the 19th century marked the origin of the company pension plan as a source of income during old age. In 1875 the American Express Company established a system for retiring permanently incapacitated workers who were 60 years of age or over and had worked for the company at least 20 years. Retirement was at the discretion of the executive committee of the board of directors and required the recommendation of the general manager. The pension allowance was half of average pay earned during the ten years preceding retirement, but not more than $500 annually. Benefits were financed by the company from current income.

Shortly thereafter several railroads adopted programs—or informal arrangements—for pensioning superannuated employees. A few isolated plans are recorded in other industries, but in most cases they were abandoned after a few years. Pension schemes were slow in developing and there were probably fewer than ten plans in operation by the end of the century. The only form of public support in old age continued to be the veteran's pension.

1900–1924

Early in the new century a number of rapidly growing corporations established retirement programs. These were principally railroads, utilities, and firms in the metal industry, although a few banks and manufacturers were represented.

During this same early period of the 1900's trade unions evidenced interest in arrangements for old-age income for members. The first of such plans was adopted in 1905 by the Granite Cutters, followed two years later by the first of the large international unions, the typographers. Early plans of this type were supported entirely by members and tended to develop in those industries where there were no company plans.

By 1910 roughly half of all railroad employees were covered by pension plans, although the total number of plans in existence in all industries may not have exceeded 75 to 100. Between 1910 and 1920 the pace quickened and some 150 new plans were established. Also during this period several states considered proposals for old-age pension laws, with the first enactments coming in 1923.

The general recession period following World War I brought a slowdown in new plans, but produced an event that later proved to be a

motivating factor in the establishment of retirement plans. The Revenue Act of 1921 contained a provision exempting from taxation employer payments to, and the earnings of, trust created as part of a stock bonus or profit sharing plan. The same legislation included provision for capital gains tax treatment on sales or exchanges of capital assets but did not extend the privilege of such treatment to amounts paid to participants from such plans. The objective of this legislation was to provide the incentive for increased business activity—to start the economy on the road to recovery by attracting managers and workers with the prospect of sharing the results of the extra efforts required to get business out of its post-war slump.

Several other significant developments in the history of pension growth occurred before the end of the first quarter of the 20th century. First, state and municipal governments began to adopt retirement programs for their employees. In 1921 the Civil Service Retirement Act brought coverage to most federal civilian employees. Also in 1921 the first group annuity contract was issued by a U.S. life insurance company.

Summarizing the first fifty years of retirement plans from the fragments of data available, the record shows the following progress:

Private retirement plans.—About 300 plans were in operation covering nearly three million workers, or about 11% of the work force employed in private nonagricultural industries. These plans were probably generating about $22 million of annual retirement income for some 42,000 retired workers.

Public employee retirement plans.—The number of plans and extent of coverage is unknown. The only evidence of their magnitude is the fact that governmental units expended about $36 million in 1922 and $64 million in 1927 for employee retirement benefits. If the growth rate during the intervening period was fairly constant, the 1924 expenditure might have been about $46 million.

The dollars produced by both private and public employee retirement plans at the end of the first quarter of the 20th century probably represented a very modest portion of the total income needs of people age 65 and over. If spread equally among the older segment of the population, the $68 million estimated payments in 1924 would have provided each person about $12 for the year. For those fortunate older persons actually receiving benefits from private pension plans, the annual amount was in the neighborhood of $500.

The income needs of the older person thus continued to be met to a large extent by the same informal sources (family members and continued employment) that prevailed in earlier years. There is also evidence that private charitable sources (such as churches, fraternal orders, etc.) and local governments played a role in supporting the needy aged whose family structures had dissolved and who had no income from employment or pensions.

1925–1949

This 25-year period marked the transition of retirement plans from the relatively simple arrangements of their early developmental period to the complex structures they are today. Three landmark events grew out of the economic and social conditions of the period that shaped

the future development and role of retirement plans and other old-age income sources. These events were the granting of tax exemption to private pension plans, the passage of the Social Security Act, and the refusal of the U.S. Supreme Court to review an earlier decision that required employers to bargain with labor unions on the issue of pensions, together with the subsequent findings of the steel industry fact-finding board that industry has an obligation to provide pensions and welfare benefits for workers. Each of these events is discussed further below in relation to the conditions that fostered its occurrence.

Tax exemption for private plans.—The first fifty years of pension growth had passed with virtually no concern about taxes or tax exemption. Nor was there need for concern prior to the imposition of income taxes on corporations in 1909 and on individuals in 1913. As mentioned earlier, the first formal provision for tax exemption of employee trusts enacted in 1921 applied only to profit sharing and stock bonus plans. It was not until 1926 that tax exemption was extended to pension plans, and even then it resulted from a Senate floor amendment to the Revenue Act of 1926 to include pension plans along with stock bonus and profit sharing plans.

Prior to the adoption of statutory authority for tax exemption, the income of employee trusts was taxable either to the employer, the employee, or to the trust itself, depending on the terms of the trust instrument. Amounts contributed by employers to such trust funds were generally taxable income to the employee at the time paid unless his rights under the plan were so contingent on future events that it would be unreasonable to impose a tax on the basis of currently realized income.

The original tax exemption legislation of 1921 and the extension to pension plans in 1926 imposed no limitations on employer deductions and no special rules relating to coverage. Most of the restrictions currently existing in tax legislation were adopted in a series of tax bills between 1928 and 1942. Those of major importance include:

1928—provisions added relating to deduction of employer contributions in excess of requirements for benefits accrued during the current year. The Revenue Act of 1928 permitted reasonable payments made to a trust to be deducted over a ten-year period. According to the report of the Senate Finance Committee, the purpose of this provision was twofold: (1) to encourage the financial and actuarial soundness of pension plans by funding liabilities for previous service through regular or lump-sum payments and to permit employers who had carried past accumulations as a book reserve to transfer them to a trust fund with the permitted deductions prorated over ten years, and (2) to prevent companies from concentrating pension deductions in years most advantageous from an income tax standpoint.

1938—added requirement that employer contributions be irrevocable with no diversion of funds permitted for purposes other than the exclusive benefit of employees. The purpose of this legislation was to prevent the possibility of pensions becoming a tax avoidance device whereby employers could set up funds in good years and later recapture them in years of financial distress. Even though the return of such funds with their accumulated earnings would represent taxable

income, in years of loss their recovery would simply reduce the amount of loss without affecting tax liability.

1942—minimum coverage requirements added; provision added prohibiting discrimination in contributions or benefits in favor of higher-paid employees: deductions for employer contributions to fund past service pensions liberalized to 10% of past service liability or an amount when combined with current service contribution would not exceed 5% of covered employee compensation; capital gains tax treatment extended to single-sum distributions to employees at termination of service.

The changes made by the 1942 Revenue Act were in part restrictive and in part liberalizations of earlier tax provisions. The restrictions imposed (coverage and nondiscrimination requirements) were largely corrections of omissions in the original tax exemption law which had become obvious during years of experience with such legislation, and which had been accentuated by changing economic conditions. The absence of such requirements had led to the creation of some plans for the benefit of a few key individuals within companies, which in operation were merely tax avoidance devices rather than bona fide retirement plans.

As early as 1937 the President had pointed out to Congress that attempts to encourage employee retirement plans through special tax treatment had resulted in tax avoidance and requested that an investigation be made. When Congress failed to enact coverage and nondiscrimination requirements in 1938, the Treasury Department attempted to institute standards of this nature in its Regulations implementing the changes made by the Revenue Act of 1938. In 1940 the Treasury Department was forced to amend its Regulation in this regard because of the absence of statutory authority and several adverse decisions by the Board of Tax Appeals. World War II finally provided the stimulus for Congress to give legislative approval to close some of the loopholes of earlier tax laws.

The liberalization features of the 1942 Act were further expression of the principle of incentive taxation, a subject which had been broadly explored by a Congressional Committee in 1938 in connection with the use of profit sharing arrangements as a possible solution to stimulating the economy.

Enactment of the 1942 changes was aided by the fact that World War II was on and wage and salary controls were in effect. Methods of compensating workers for increased production efforts without adding to inflationary pressures were needed. One solution was to channel compensation into non-cash deferred forms such as qualified pension and profit sharing plans.

The need was apparent therefore for change in the revenue provisions to accomplish this shift in emphasis; hence the minimum coverage requirement and the ban on discrimination.

Social Security Act.—Conceived and created out of nearly five years of economic depression, the Social Security Act of 1935 was a sweeping piece of legislation designed to provide some form of economic security for almost every American citizen. The vast program of Old Age and Survivors' Insurance, to which workers and their employers commenced contributing in 1937, became an important source of old-age income from the time benefits became payable in 1940.

The program of federal grants to states for Old Age Assistance provided for in the Social Security Act had an even more significant impact as a source of old-age support during the early years of the program. It was not until after the OASI program was greatly expanded by legislative action in 1950 that it produced as many dollars of support as Old Age Assistance.

Revolutionary as the Social Security Act was to the American way of life in the 1930's, the United States was among the last of the major industrial nations of the world to establish a social insurance system.

Supreme Court confirmation that pensions are subject to bargaining.— In 1947 the National Labor Relations Board ruled (in the well-known Inland Steel case) that employers are required to bargain on pension plans under the Labor-Management Relations Act of 1947. The following year the Seventh Court of Appeals upheld the decision, and in 1949 the Supreme Court affirmed it by refusing to review the case. These decisions, coupled with the steel industry's fact-finding board ruling in 1949 that pensions are an appropriate responsibility of industry, led to a rapid extension of the private pension movement. With coverage no longer a matter of voluntary, unilateral action, almost all major U.S. corporations were faced with negotiating plans for hourly workers. Most of the impact of the Supreme Court's action, of course, came in the early 1950's, with the auto and steel industries largely responsible for the patterns that emerged.

Economic conditions during the 1930's and 1940's had a profound effect on the development of old-age income sources. Although the economy was moving in opposite directions in the two decades, there were contributing factors in each period that increased the momentum for both public and private programs of income assurance in old age.

The Depression of the 1930's had been a bitter lesson for the American worker and had taught him to value economic security more highly than he had in earlier years of prosperity. The Social Security Act, which grew out of the Depression, had as one of its primary objectives the removal of older workers from the labor force to create work opportunity for the young, and did much to establish the propriety of retiring older workers at a set chronological age. The combination of Depression experience and social security providing a basic floor of old-age income influenced the attitudes of employers and workers alike to favor the establishment of private retirement plans that would assure a modest, rather than a minimum, level of retirement living.

Apart from the security aspects of private retirement plans, the expanding war-time economy of the early 1940's increased the attractiveness of tax deferment privileges. Although this was not a new aspect of qualified plans, it was not until the 1940's that the bulk of American workers felt the impact of income taxes. Prior to that time the average worker realized little, if any, advantage from tax deferment on amounts contributed by his employer to retirement plans. For example, in 1935 a single man earning $5,000 a year (and it should be remembered that $5,000 was a substantial salary in 1935) paid only $140 in income tax. In 1942 the tax on the same earnings was $920, and the value of the $5,000 income was considerably depreciated. If

the salary of this man had kept pace with the general trend of compensation during the seven-year period, the $5,000 would have grown to about $7,500 by 1942 and the income tax would have been about $1,600. In other words, the tax effect increased tenfold while the individual merely maintained his before-tax economic status.

Another event that resulted from the Depression was passage of the Railroad Retirement Act in 1935. While the railroads were the first U. S. industry to adopt pensions widely (some 80% of all railroad employees had pension coverage by the end of 1927), many plans ran into financial difficulties during the early 1930's and some were forced to reduce pension payments. This situation compounded the problem of unemployment in the industry, since many of the older railroad workers who might have retired under normal conditions could not, or would not retire on reduced pensions.

An interesting occurrence of the late 1930's was the inquiry of the U.S. Senate into the desirability of incentive tax legislation in connection with deferred profit sharing retirement funds. The report issued in June 1939 by the staff of the Subcommittee on Finance (commonly known as the Vandenberg Report) included two specific recommendations for legislation: (1) exemption from income tax of all payments to employees from profit sharing retirement funds, and (2) establishment of a special U.S. Government Profit Sharing Fund Bond to be used for the protection of profit sharing fund investments. The impetus for the investigation was the desire to find methods of restoring vigor to the U.S. economy by reducing labor unrest and the unemployment rolls. While no legislation resulted directly from the inquiry, changes enacted by the Revenue Act of 1942 reflected some of this earlier thinking in adopting new provisions requiring broadened coverage of employees under tax-qualified plans and nondiscriminatory treatment of participants, and in the extension of capital gains tax treatment to lump-sum distributions from employee trusts.

Summarizing the events of the 1925–1949 period, the common sources of financial support in old age had been expanded to include Old Age and Survivors' Insurance, Old Age Assistance, and Railroad Retirement in addition to continued expansion of the role of private employee retirement plans and government subsidy of aged war veterans. Private retirement plans had grown to over 12,000 in number and in coverage to about nine million of the 37½ million workers employed in private, nonagricutlural business. Total retirement income produced by these plans was in the nature of some $300 million annually for perhaps 400,000 recipients. (Precise data is not recorded for the period before 1950, but an estimate of this magnitude is reasonable for 1949 on the basis of later figures.)

Social security contributed $439 million to old-age support by 1949, while Old Age Assistance payments totaled $1,380 million. Payments to retired railroad employees added another $234 million to the growing list of sources.

1950–TODAY

Most of the growth in formalized sources of old-age income from 1950 to the present can be attributed to expansion and extension of programs created by events of earlier periods.

Social security, for instance, has undergone numerous revisions with each change resulting in either greater benefits for existing beneficiaries or extending coverage to new groups, or both. One major change in the program, the medical benefits provisions enacted in 1965, is more in the nature of income protection than income production.

Developments affecting private retirement programs were relatively minor in nature. A few changes in the tax treatment of pension and profit sharing plans occurred, and in 1958 plans were subjected to reporting and disclosure legislation. The major impetus for expansion came from the necessity for employers to negotiate plans with collective bargaining agents.

In 1962 Congress extended limited tax exemption privileges for the first time to self-employed persons who chose to establish retirement programs for themselves and their employees. These tax privileges were extended in 1966 and are now comparable to the treatment accorded employees of corporations under profit sharing or future service pension plans.

By the end of 1965, well over 100,000 private retirement plans were in operation, covering more than 25 million persons—which is one out of every two workers employed in private, nonagricultural industry.

The plans provided about $3.2 billion toward the financial support of 2¾ million retirees. In 15 years retirement income from private plans increased more than tenfold while the number of beneficiaries increased nearly sevenfold.

Dramatic as the growth of private retirement plans was in contributing to financial support in old age, it was far surpassed by social security. Old-age benefit payments in 1965 were nearly 29 times those paid in 1950! Old Age Assistance payments increased only slightly during the 15-year period, while the dollars of support from railroad retirement and veterans pensions each roughly quadrupled.

As an illustration of the evolution of formalized systems for old-age income, Exhibit A represents a graphic chronology of both private and public sources from 1900 to the present time. It reflects the growth in the number of dollars produced by the various sources against the background of existing conditons which influenced their development. Unfortunately, the picture before 1930 was, by necessity, constructed from fragmentary and incomplete information. If a true and complete history could be compiled, formal sources of old-age income during this early period would be credited with producing more dollars of support, but it is doubtful whether the additional amount would significantly alter the pattern of growth depicted by Exhibit A.

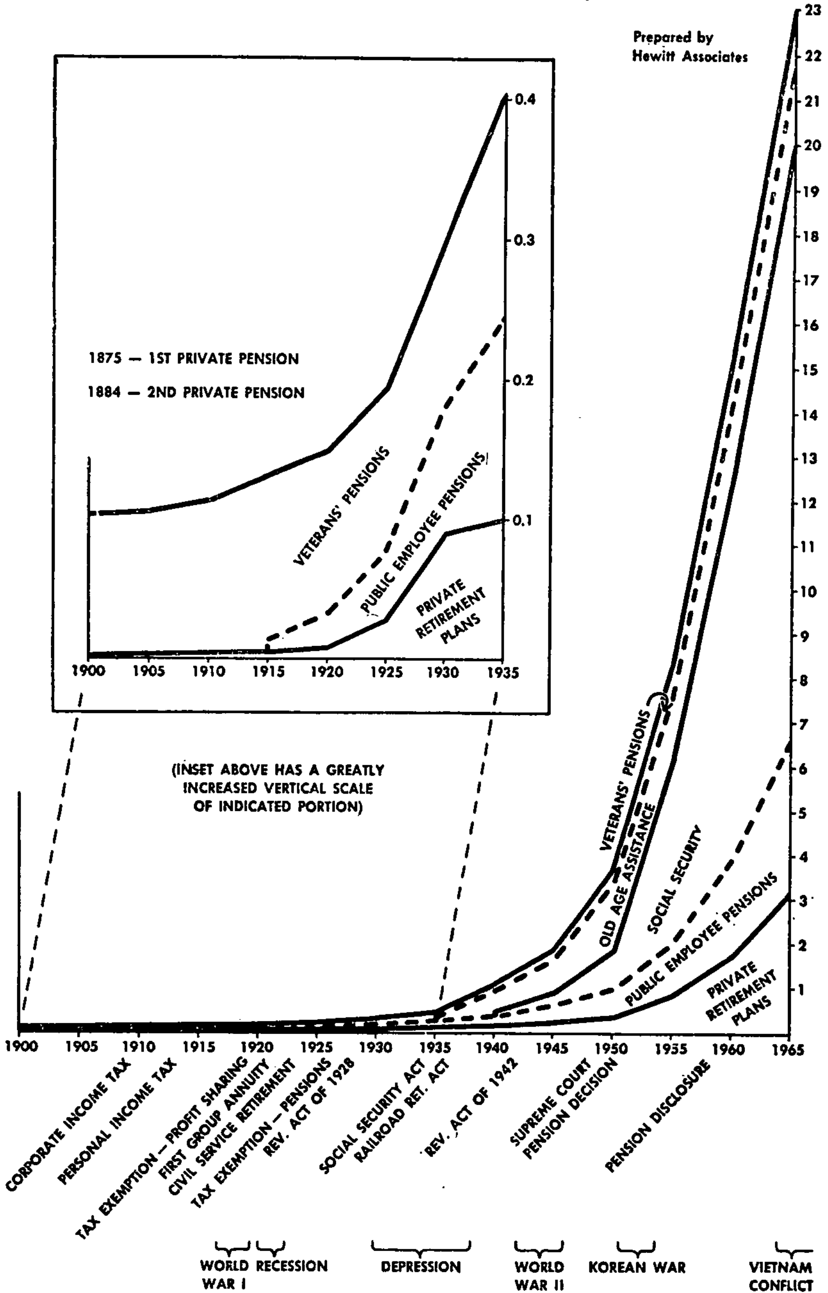
Translated into annual income on a per capita basis for the age 65 and over segment of the population, the payments from all sources increased as follows:

Year	Amount	Year	Amount
1900	$32.55	1940	$119.96
1910	28.61	1950	297.95
1920	25.34	1960	922.64
1930	45.22	1965	1,266.30

The dip in the per capita rate during the early years was due to the fact that the number of people age 65 and over was increasing more rapidly than dollars available from all sources for their support.

Exhibit A – HISTORY OF OLD AGE INCOME SOURCES

(In billions of dollars produced annually)



The foregoing comments and illustrations are intended to put into proper focus the events of the past that have brought us to the present state of affairs, and to shed some light on possible future directions in the management of old-age income financing. Three somewhat obvious conclusions can be drawn from the experience of the past ninety years.

First, changing economic and social conditions of the past century have led to general acceptance of the desirability of organized systems for old age income maintenance.

Second, the private movement of business and industry to provide income assistance for aging workers was a logical outgrowth of the employment of large numbers of workers in a single business enterprise which made earlier forms of providing for older workers impractical and obsolete.

The same reason can be cited for the initiation of retirement systems for employees of governmental units.

Third, government has assumed the dominant role in the creation and maintenance of old age income systems. The original role of government was limited to that of employer, then expanded via tax legislation to encourage other employers to establish programs, and finally to the enactment of compulsory legislation requiring workers and employers alike to contribute to the financing of old age.

A fourth related point, which may not be obvious, is that the effectiveness of permissive tax legislation as an incentive to the accumulation of retirement income is directly related to the impact of taxation on the income of individuals rather than on the income of business.

II. Current Status of Old Age Income Sources

Exhibit A indicates that by 1965 the combined sources of old-age income were producing nearly $23 billion of annual income, more than $1,250 per capita if spread equally among the age-65-and-over population. More than half of the total income was provided by the OASDI program under the Social Security Act. If other government-sponsored systems are taken into account, the portion of total retirement income provided by government is 71% exclusive of programs for the benefit of its own employees, and 84% including those programs. This means that private employee retirement plans are producing only 16% of the total of all formal sources today, although the employers and workers in private industry are directly responsible for the financing of about 72½% of the income generated.

Recent estimates of the U.S. Department of Health, Education, and Welfare indicate the aggregate income of all older persons is over $40 billion a year. This leaves $17 billion of annual income which is provided from personal assets and savings, family assistance, charitable sources, and continued employment. At the $40 billion annual income rate, the resulting per capita income of $2,200 for persons age 65 and over is several hundred dollars under the 1965 national average of about $2,750 for all age groups.

Undoubtedly, the measurement of the progress of private retirement plans as a source of old-age support in terms of the dollars currently produced does not give full credit to their actual present value. Extensive coverage of American workers is a relatively recent phenomenon; many of the persons whom plans have been designed to cover are still actively employed and amassing retirement income credits for the future. It may be another decade or two before the effect of today's coverage can be measured in terms of income produced. In order to provide a clearer picture of the role of private retirement plans, Exhibit B summarizes the extent of coverage under such plans, as well as those providing income protection for employees of government.

The current status of old-age income sources cannot be fully described by tabulating and charting statistical data. The nature of the roles played by the various sources needs to be defined before moving on to the future outlook for old-age income sources.

VETERANS' PENSIONS

Most veterans' pensions are neither true pensions nor an intentional source of old-age income. Only a small portion of today's veterans' pensions are paid as a right earned by virtue of military service (performed outside the Regular Establishment). They are paid only to veterans of wars prior to World War I. Most of the so-called veterans' pensions fall into the classification of non-service-connected pensions, which apply to unemployable veterans with limited incomes. A veteran is generally considered totally and permanently disabled at age 65 if he is retired from employment and has a 10% disability. Payment of the benefit is dependent on proven financial need. In 1965 nearly a million veterans of World War I were receiving over $1 billion in this form of income; thus over 5% of the aged population were benefiting from this unintentional source of old-age income.

The role of the veterans' pension as a source of old-age income is primarily one of filling certain income gaps that exist among a special class of older citizens. Unless Congress should see fit to extend "service" pensions to veterans of World War I and later wars, the role of the veterans' pension should diminish in relative importance as other forms of retirement income provide the financial means of living in old-age.

OLD AGE ASSISTANCE

The role assigned to old-age assistance programs has been generally that of a stop-gap measure designed to fill a financial need during the period between enactment of the Old Age and Survivors' Insurance program and the time when its provisions would be fully operative and filling the basic income needs of the preponderance of older citizens. Evidence that Old Age Assistance is performing this function can be found in the relatively constant number of dollars expended by such programs during the past 15 years and by their diminishing importance as a factor in old-age financing.

OLD AGE AND SURVIVORS' INSURANCE

The role assigned to the Old Age and Survivors' Insurance Program under the Social Security Act is to assure a basic floor of old-age income to all workers and their dependents, without requiring the recipient to prove financial need. The system was thus designed to simulate the characteristics of an insurance arrangement rather than a welfare program.

To achieve the goal of income assurance, the system required broad coverage of American workers, which has been accomplished through the intervening years since 1935 to the point where coverage is now, for all practical purposes, universal.

In keeping with the insurance image of the system, payments to and benefits from Social Security have been expressed in relation to earnings and years of coverage, while the right to receive benefits has been related to broad concepts of what constitutes an individual's need to receive income from the system.

Although Social Security represents the single largest source of retirement income today, fulfillment of its assigned role can be frustrated in two major areas:

1. Identification of what constitutes the basic floor of income that the public is willing to underwrite on a compulsory, universal basis. To date this level has been determined largely by political pressures of the moment with little, if any, attempt to relate benefit levels to some factual measure of income needs of older citizens.
2. Attempts to erode the original insurance concept of Old Age and Survivors' Insurance through periodic legislative amendments that have sacrificed the implied relationships between payments into and benefits from the system in the interests of attaining universal benefit coverage for older citizens.

PUBLIC EMPLOYEE RETIREMENT SYSTEMS

The role of public employee retirement systems is virtually identical to that of private systems with the possible exception that in many cases the public system is not a supplement to Social Security, but performs both roles simultaneously. Governments, as employers, as seeking in their retirement systems the same vehicle as private employers to provide for the systematic accumulation of adequate retirement income and for the orderly removal of workers whose skills or capabilities become inadequate because of aging.

PRIVATE RETIREMENT PLANS

The primary role of private retirement plans has been to provide a vehicle through which a corporate employer could systematically provide income maintenance for workers who become nonproductive because of the aging process, by means of diverting earnings during the productive years to retirement income. The role has been performed either through unilateral employer decision or by providing the means for voluntary employee saving for old age. The private retirement plan actually is a continuation of the earlier practice of smaller, more personally-involved employers of providing old-age income

through continuation of employment of nonproductive older workers or by extending personal gratuities in selected cases.

With the advent of social security, the role of the private retirement plans was enlarged to provide a "living" income level commensurate in some way to the income earned during the working career, as differentiated from the basic floor of income provided by the public program and to a large extent under earlier private plans which had been the sole source of old age income for many workers.

A third important aspect of the private retirement plan is that it permits tailoring of benefits to meet special needs of an employee group to a degree which is impractical under a universal system. For example, there can be greater flexibility in determination of an appropriate retirement age to meet special employee or employer needs. Early retirement in cases of work force reduction or plant shutdown (which is possible only under the private retirement system) does much to relieve the unemployment situation of older workers who would otherwise be at a severe disadvantage in finding suitable employment until they reach "normal" retirement age.

The end result of the role played by private retirement plans is a series of advantages to society in general, which can be identified as follows:

1. Increased vigor of the labor force through selective retirement of workers with obsolete skills or inadequate education, and the creation of job opportunities for younger, better educated employees.
2. Enhanced ability of the industrial sector of the economy to modernize production techniques with minimum displacement of workers resulting from "retirements" as opposed to "terminations."
3. Increased consumer purchasing power of older citizens.
4. Elimination of hardship in cases where the individual has no resources other than social security or old age assistance.

Several characteristics of the private pension movement are worthy of noting in assessing where we stand today and what future course might be expected. The public is prone to think of "private pensions" solely in terms of the plans operated by medium to large-sized corporations. While plans of this kind may typify the private pension scene, they are not its entire substance.

Today's private pension sector is actually composed of arrangements of several different basic natures. These can be classified and described as follows:

1. *The corporate pension plan*—or the "typical" plan referred to above which is adopted and maintained by a single employer for the benefit of all, or of special classes, of his employees. It is usually a funded, tax-exempt arrangement which is subject to the rules and regulations of the U.S. Treasury Department, the U.S. Labor Department, and the Securities and Exchange Commission.

2. *The joint labor-management pension plan*—which is an outgrowth of the trade union plan in which the union set up the mechanism for collecting funds and distributing benefits. The 1947 Taft-Hartley amendments to the National Labor Relations Act made it unlawful for an employer to pay any money to a bargaining representative of his employees, except that payments were permitted to trust funds established for the exclusive benefit of employees if the employer and employee representative had equal representation in

administering the trust fund. This legislation, together with the later action of the Supreme Court in confirming that pensions were a bargainable issue, led to the development of negotiated joint labor-management pension trusts, with employers tpyically agreeing to make contributions on behalf of workers in terms of cents per hour.

The joint labor-management trust was one of the first major efforts to extend tax-free retirement income accumulations to workers in small business enterprises—at least to those who were members of the unions negotiating plans. This is not to imply that joint labor-management plans cover only small employer groups, although it is true that this type of plan has flourished chiefly among "trade" unions as distinguished from industrial unions, where the practice has been to negotiate individual employer plans.

3. Association plans—these are plans usually sponsored by a business or trade association, which offer voluntary participation to member employers, and are subject to the government regulations applicable to the corporate and joint labor-management pension plans. While these plans share the common objective with the joint labor-management plan of providing a central mechanism for establishing and maintaining a retirement program, they differ in methodology. The association usually arranges details of the program and then delegates management control of funds to a third party, such as an insurance or financial institution, whereas management control is vested by law in the labor-management trustees of jointly-managed funds.

4. Self-employed plans—these are qualified retirement plans that were first authorized by Congress in 1962. Prior to that time noncorporate businesses could set up plans for employees, but partners and proprietors were excluded from participation. The brief period of experience with these plans has been disappointing, and the lack of acceptance is probably attributable to three major reasons:

a. The mechanics for establishing self-employed plans are approximately parallel to those for corporate plans, and the cost in money, time, and effort is prohibitive if prorated over a small employee group.

b. Experience to date results from the original legislation which limited the tax advantages offered to owner-employees. This situation was remedied by legislation in 1966, but its effect is not yet evident.

c. The nature of self-employed business activity is such that employees are few and frequently of short tenure. The need for an orderly system of retiring workers has not existed to the same extent as it has in larger business organizations.

The Tax Code provision that all employees with three or more years of service must be covered has undoubtedly created some resistance on the part of many self-employed proprietors and professional persons.

Group arrangements for covering self-employed persons and their employees have been developed by a number of professional and business organizations. Insurance companies and financial institutions have also developed prototype plans to simplify the qualification and operation of self-employed plans.

5. *Bond Purchase Plans*—are arrangements under which special U.S. Retirement Plan Bonds, which are sold by the Treasury Department, are used to provide retirement benefits under approved plans. The device became effective in 1963 and is used primarily to provide self-employed individuals a means of investing their retirement

plan contributions. However, any qualified corporate pension plan may also purchase such securities. Each bond purchased is issued in the name of the individual employee, or self-employed person. It is nontransferable, nonforfeitable, and cannot be redeemed until the individual reaches age 59½, dies, or becomes disabled. Bonds become taxable when redeemed.

6. *Tax-sheltered annuities*—which are special arrangements, authorized by legislation since 1939, for the benefit of persons employed by tax-exempt organizations. These are typically nonprofit religious, charitable, scientific, or educational organizations. Qualified employers may purchase nonforfeitable annuity contracts for employees, who may exclude from taxable income such employers payments up to 20% of pay for each year of service. Since 1958, the annuity payments have been permitted as the result of a reduction in the employee's salary if a suitable salary amendment agreement is adopted. The same exclusion from income tax is permitted as if the employer paid for the annuity in addition to pay. Amounts received from the annuity contract are included in taxable income in the year received.

7. *Other arrangements*—which include diverse approaches to group action are also in operation. These include area-wide and industry-wide plans as well as the recently-established small employer plan sponsored by the industrial union department of the AFL–CIO.

It is readily apparent that most of the methods in use are for the primary purpose of simplifying the complicated tangle of rules and regulations covering the operation of qualified private retirement plans to the point they can be made economically attractive to small groups.

The current status of old-age income sources cannot be fully described without noting that the single private source of retirement income (employee retirement plans) has been the subject of extensive review and re-appraisal during the past five years. The review was initiated as a result of a report of the Commission on Money and Credit published in 1961. This report recommended that an appropriate regulatory body be given responsibility over private corporate pension funds to study and develop standards of fund investment, to enforce such standards, to require periodic reporting to beneficiaries, and to bring legal action against malfeasors on behalf of plan participants and beneficiaries.

Within a few months after publication of the report, President Kennedy named a Cabinet-level committee to review the implications of retirement plans for the financial structure of the economy as well as the role and character of retirement systems in the economic security of the nation, and to consider how they might contribute more effectively to efficient manpower utilization and mobility.

Nearly three years later the President's Committee on Corporate Pensions submitted its report to the President under the title of "Public Policy and Private Pension Programs." One of the major conclusions of the report was that:

> "Private pension plans should continue as a major element in the nation's total retirement security program. Their strength rests on the supplementation they can provide to the basic public system.
>
> "The basic justication for the indirect public subsidy involved in favored tax treatment lies in the social purposes served by

private pension plans. In view of these social purposes, public policy should continue to provide appropriate incentives to private plan growth, and by improving the basic soundness and equitable character of such plans, set a firmer foundation for their future development. Because protection will always be far from complete, private pension plans cannot be a substitute for public programs, but public policy can encourage developments which will provide supplementary retirement benefits to a growing proportion of the nation's workers and will provide greater assurance that the promised benefits will be paid."

The report goes on to outline specific recommendations for achieving the desired "basic soundness and equitable character." These include establishment of vesting requirements, minimum funding standards, more stringent requirements for qualification for tax-exempt status, restriction on investments in employer securities, and elimination of some tax advantages currently available to employees. The report also concludes (although not included as a formal recommendation), that proposals for arrangements for portability of pension credits and for insurance of benefits in event of plan termination are worthy of study.

In the two years since the report of the President's Pension Committee was released, a great deal of study and attention has been given to its content by representatives of government, labor, business, academic institutions, and of the so-called public interest. The resulting dialogue encompasses volumes of written words and countless hearings and meetings of study groups, and Congress has received numerous proposals for translating recommendations of the Committee into legislative reality.

Within this framework of past history and current status, it is appropriate to view the future outlook of old-age income.

III. Outlook for Old Age Income Sources

There are basically two methods of viewing the future of retirement income sources:

(a) on the assumption that future developments mainly will follow the pattern of the past and vary to accommodate changing conditions caused by the same economic and social forces that have influenced earlier events, or

(b) on the assumption that some major change will occur in the basic structure of old age financing.

FOLLOWING THE PATTERN OF THE PAST

If the "status quo" mood prevails, a projection of the trend illustrated in Exhibit A suggests that 50 years hence it is not unlikely that 95% to 99% of all retirement income will be generated as a result of government action, either in the form of direct outlay from general revenue sources or the product of compulsory legislative requirements.

It appears almost certain that the OASDI program will continue to expand until every nonworking older citizen is within the scope of its benefits. The dollars of benefits produced on behalf of each individual beneficiary will have to grow to keep pace with living costs if

the system is to fulfill its stated role of providing a basic floor of old-age income protection. An even more important consideration is the extent to which this role exceeds what social planners refer to as "the subsistence level". If this occurs to any appreciable degree, the volume of income that will be produced for old age social security beneficiaries in 2015 would stagger today's imagination. Assuming that social security does not grow to the point of rendering other forms of old age income unnecessary, it would still be consistent with past history to expect government to play a major role in old age financing through continuation of the old age assistance programs now in operation, or as part of some expanded program for the alleviation of poverty among all age groups.

The effect of the "status quo" condition on private employee retirement plans is more difficult to assess. Certainly, the tax incentives originally extended to employers to establish retirement programs have been gradually hampered by restrictions and regulations that affect their attractiveness to employers. At the same time the attractiveness to employees has increased because of the growing impact of income taxes. The steady growth record of private retirement plans stems not from tax advantages to employers, but from the function they serve in the orderly removal of unproductive older workers from the payroll, combined with the tax advantages accruing to employees.

If Congress sees fit to further regulate and control the affairs of corporate pension and profit sharing plans, the day may come when the burden of administering programs for the tax benefit of employees may exceed the value of the program to private employers. If that day arrives, Congress will be faced with the choice of taking over and operating an industrial retirement system (as it did the railroad system in 1935) or of compelling private employers to maintain retirement systems as a matter of legal responsibility. On the other hand, if Congress limits its concern to the prevention of abuse of the tax privileges currently enjoyed by private plan participants (without legislating plan provisions) private plans will probably continue to play a growing role in the aggregate of retirement income sources. Either course is a likely description of the road ahead, and the day of decision as to which course we follow is not far away.

DEVELOPING MAJOR CHANGES

In view of all the attention currently devoted to public policy on private pensions, this may be an appropriate time to go a step further and review public policy on all aspects of old age financing. The American public might well ask those who determine its policy the following series of questions.

1. What constitutes reasonable goals for old age income?
   a. a minimum subsistence level?
   b. a modest standard of living?
   c. pre-retirement standard of living?
2. Whose responsibility is it to provide the desired level?
   a. government?
   b. employers?
   c. individuals?

   d. family?
   e. charity?
   f. combination—or different responsibility at different levels?
3. What form should old age support take?
   a. guaranteed income unrelated to past work?
   b. income based on past work history?
   c. income for work performed; even if job must be created?
   d. as a matter of "right"?
   e. provided to meet need?

The most desirable solution for society, of course, would be for every older citizen to continue his pre-retirement standard of living out of his own resources accumulated during a working career of full and adequately-compensated employment. The minimum that most Americans are willing to settle for is assurance that no one in our society is without the basic necessities of life, but fixing responsibility for this minimum is another matter, as is identifying the need by classification or by individuals. In the absence of adequate and clear-cut private channels for satisfying minimum income needs of older citizens, government has assumed the responsibility, first at the local community level, later at the State level, and now largely through Federal sponsorship of programs in cooperation with State and local governments.

Minimum income objectives are met chiefly through the mechanism of the OASDI program, supplemented where required by old age assistance payments and veterans pensions. The OASDI program grants benefits on the basis of past work history without regard to financial need while the other two programs are based entirely on need and have no relation to work history.

Somewhere in between the ideal of a continued pre-retirement standard of living and the subsistence amount from government programs is the "modest level" of living standard. This is a level that private retirement plans commonly attempt to reach when benefits are added to those of social security. Other plans relate retirement benefits to earnings before retirement, and in so doing may exceed what is ordinarily considered a modest level. (A "modest but adequate" level of living for an elderly couple has been defined and measured in dollars by the Bureau of Labor Statistics, most recently in the fall of 1960. At that time annual income needs ranged from $2,641 to $3,366 in 20 major U.S. cities. Changes in prices of goods and services since that time would require a range of $2,932 to $3,676 in the same areas in the spring of 1967.)

In the absence of benefits from an employer retirement plan, workers are left to their own devices to supplement social security to an acceptable standard of living. Where a plan is in operation, a living standard beyond that produced by social security and the retirement plan is also the private affair of the individual.

An appropriate corollary question in assessing public policy for old age financing is: Assuming that the Utopian goal of continuing the pre-retirement living standard is unrealistic and further that the subsistence level is now generally assured by government programs, how can more of our aged citizens be assured the modest level now enjoyed by most retiree beneficiaries of private plans?

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Increase Social Security?—One answer is to expand the social security system to the point where benefits would provide a modest level of living rather than a subsistence level. Some social planners seem to favor this approach. Other students of old age financing are unalterably opposed to such a suggestion. Perhaps the most compelling argument against such an expansion is that the basic structure of the system probably could not support such a demand. Social security is not a true insurance arrangement where each individual's payments are held in reserve for his future use; instead it is a system of transfer payments where payments made by and on behalf of today's workers are being used for the current support of today's retired population. Today's workers will in turn be supported by the payments made by tomorrow's work force. The ability of the system to fulfill its support commitments at any given time is dependent on the delicate balance of three factors: the ratio of retired beneficiaries to the working population, the amount of dollars required for retiree support, and the willingness and ability of workers to assume the obligation of payment in return for the federal government's promise that tomorrow's work force will do the same for them.

Whenever one of these factors gets out of line and upsets the balance, some compensating adjustment must be made. For example, when benefits fall below the desired level or when the number of beneficiaries suddenly increases, the system requires more dollars for current benefits and must increase tax rates or the taxable wage base, or both. As long as the economic climate is such that the working force is able to provide the additional revenue, balance is restored and the system remains healthy. But if a severe depression should occur, or the ratio of the population over age 65 to the working population should increase beyond present expectations, the capacity of the work force to increase payments for the aged would be seriously affected at a time when demands for benefit payments could be expected to increase. The likely solutions to maintaining the system under such conditions would be to reduce benefits or seek funds from general tax sources.

Expansion of social security to provide a modest level of living would put increased pressures on the system and could destroy the balance mechanism to the point of endangering the basic floor of protection it now provides.

Expand private retirement plans?—Theoretically, at least, this is one of the recommendations of the President's Committee on Corporate Pensions and the subject of much discussion in both government and private circles.

Expansion of coverage under private plans is continuing with about a million workers added to plan rolls each year. However, the work force is growing by approximately the same number every year so that little if any progress is being made in reducing the number of persons without pension coverage.

A forecast of the future spread of retirement plan coverage must take into account the characteristics of the principal groups of persons not covered. Exhibit C identifies these groups, their numbers, and their prospects for coverage.

EXHIBIT C.—WORKERS CURRENTLY WITHOUT PENSION COVERAGE—WHO ARE THEY? HOW MANY ARE THERE? AND WHAT ARE THE PROSPECTS FOR THEIR COVERAGE?

Who are they?	How many?	What are the prospects for coverage?
Unemployed	3,456,000	As a class, this group will probably never qualify for pension coverage since even the nearly universal coverage of social security does not provide coverage for periods of unemployment. The fundamental problem is to transfer workers from this category to a gainfully employed group.
Unpaid family workers	1,403,000	This group—also largely without social security coverage—is a marginal part of the labor force at best. With the possible exception of individual tax incentives which might apply to forms of income other than "earnings from work," it appears unlikely that this group will ever be eligible for pension coverage—certainly under existing conditions their prospects are virtually nonexistent.
Government workers	1,445,000	Many of this group are employed by small local governments where coverage is generally available by voluntary participation in an already established State-operated system. Also included in this group are a few persons who for various reasons do not qualify for participation in the programs of the government agency for which they work. The coverage prospects for the group as a whole are reasonably good.
Self-employed	8,490,000	This group is composed of 2,307,000 self-employed persons in agriculture and 6,183,000 self-employed in nonagricultural industries. The self-employed have been "potentially eligible" for pension coverage since the enactment of special legislation in 1962. Although 20,000 plans were approved by the end of 1965 only about 30,000 persons are covered. However, the machinery for coverage is now available and individual coverage should increase in volume as master and prototype plans become available. A major deterrent to the growth of self-employed coverage has been the fact that their tax incentive is considerably less than that enjoyed by employees of corporations. Legislation to eliminate this discrimination was enacted in 1966.
Agricultural workers	1,492,000	A sizable portion of this group is employed by the 2,300,000 self-employed farm operators who are now eligible for pension coverage. As such they could be covered by plans established by their employers in the same manner as agricultural workers who are employees of corporations. However, from a realistic viewpoint, the agricultural worker group will probably never attain a high level of pension coverage because of the itinerant nature of many farmworkers.
Wage and salary workers in private nonagricultural industries.	25,741,000	This group accounts for the balance of all workers presently without pension coverage. Its number is currently being reduced at the rate of approximately a million each year who are added to the rolls of "covered" employees. However, the total labor force is growing at a roughly equal rate, about a million persons annually. So in effect, while the number of persons with coverage is increasing, we are standing still as far as reducing the number not covered. The available data on pension coverage do not indicate whether the approximate million persons being added each year results from the establishment of new plans or from additional employees covered under existing plans. It is generally agreed that small employer groups are at a serious disadvantage in establishing retirement plans—from the standpoint of cost of establishment and cost of administration. As a result, it is assumed that the number of persons without pension coverage includes a high proportion of workers employed in small employee groups. The latest figures available (for 1956) indicate that 44 percent of all persons employed at that time worked for firms with fewer than 100 employees; 36.2 percent work for firms with fewer than 50 employees. Of all employers paying social security taxes in early 1962, over 90 percent employed fewer than 20 workers. That portion of this group of nearly 26,000,000 workers who are employed in very small business operations may never attain pension coverage under existing legislation. There is an evident need for further study and development of association plans, community plans, individual tax incentives, industrywide plans, etc., to provide new methods for private coverage of small employee groups.

Note: At the end of 1965 a total of 42,027,000 workers were without pension coverage.

In a free economy, there will always be businesses that will not voluntarily provide retirement income, or that cannot afford to do so. There will always be transient and marginal workers who willingly work for such employers and who prefer current to deferred income. There will always be many part-time and temporary employees. These groups tend to distort the statistics as to how many workers are not covered by private plans at any time. The problem is that many in this

group can, by their own efforts and through the passage of time, transfer to other groups. The number of workers not covered by a plan at a specific date is not a true measure of how many will reach retirement without having been covered by a plan.

With respect to the single largest group, the 25¾ million nonagricultural workers, it should be recognized that many of these persons work for employers of smaller average size than those which operate plans today. It is likely that progress will be particularly slow among business firms of limited size. At least three reasons can be cited for the small employer's reluctance to establish plans:

1. He usually has less reason for maintaining a program of retirement benefits for employees than the larger organization has. The competitive influence of pensions in hiring and holding employees has not been significant among small companies.
2. Many of the advantages in sponsoring retirement programs do not apply to the smaller employer, or at least he does not recognize them as advantages to himself.
3. The present cumbersome procedures for qualifying and maintaining plans are not justified for the few employees involved.

The encouragement of private efforts to put aside funds for retirement has been a point of national policy for many years. The principal expression of this policy has been in the form of federal tax incentives. This device has been particularly successful among large employers. More recently the principle has been extended to self-employed individuals on a modified basis under the Smathers-Keogh legislation. In addition, tax-sheltered annuities are permitted for employees of not-for-profit organizations and public schools.

Perhaps because so much of the successful spread of private retirement plan coverage has occurred since the enactment of tax legislation, there is a tendency to assume that tax incentives have been an essential factor in the growth rate. What are these tax incentives? Who receives the benefit of them? And what role do they play in encouraging employers to institute plans? Answers to these questions may indicate future trends in the growth of private plan coverage.

A company does not initiate and maintain a retirement plan because it receives a tax deduction for its contributions, since the same tax deduction would be permitted for the same amount of money paid in wages. Employer motivation for retirement plans in most cases is for reasons completely apart from tax considerations. The reasons may include need for an orderly method of removing the too-old workers from the payroll, creation of a sense of employee security and morale, competitive advantage in the labor market, and a form of extra compensation for long service. The employer may, however, be influenced in his decision by the tax advantages his employees would realize on money put aside by the employer in qualified retirement plans.

Because of the combination of employer and employee objectives, companies are willing to start retirement plans. There is nothing that prevents the employer from paying pensions from current income as they come due; this is the course of action followed with an unfunded plan. Usually a company chooses to fund its liability in advance for a variety of reasons. For example, the company wants to guarantee that money for pensions will be available when needed; it also recognizes that its liability will grow as time passes; and it prefers to ex-

pense pension charges to income received from the results of the work that created the charge.

Even before the advent of pension tax legislation, retirement plans were started and ways found to fund in advance for their costs. After permissive tax legislation was introduced, restrictions and regulations were gradually added that prescribed limits in terms of the group covered, the type of benefit, the amount of contribution, etc. The employer must observe all these restrictions if the contributions he makes to the retirement fund and the earnings on accumulations are to be tax free to employees until received in the form of benefits. It should be kept in mind, however, that this tax advantage to employees increases as the effect of income taxes increases.

The preceding comments have attempted to answer the questions of who receives the benefit of tax incentive legislation and what role does it play in the employer decision to initiate qualified retirement programs. A third question deals with what are these tax incentives? And what is their practical effect?

The tax advantage enjoyed by employees under qualified plans is twofold: first, deferment of income tax on employer payments in their behalf and second, deferment of income tax on earnings of the fund during the accumulation period. Payments from qualified plans are taxable income when received.

The effect of tax deferment can be illustrated by comparing the net retirement income produced by a qualified plan with net income from a personal savings program. As an example, assume two young men each age 30 who work for different employers. The employer of Employee A established a retirement plan and contributes $500 annually on his behalf until he attains age 65. Employee B's company elects to give him a $500 annual pay increase instead, from which Employee B sets up his own retirement income savings program. Assume further that the two workers are in moderate tax brackets and that their highest taxable income dollars are subject to an effective rate of 20% and that investment earnings on both retirement income accumulations average 5% annually.

At retirement age, the value of Employee A's tax-free accumulation is $47,418 ($500 contributed yearly for 35 years with 5% annual earnings) while Employee B's after-tax accumulation has grown to $30,639. The effect of taxes has eroded his savings in two ways: his $500 salary increase provides only $400 for saving after payment of taxes, and his 5% annual earnings are equivalent to 4% after taxes. Employee A, however, now has to pay taxes on his fund. If he receives the money in a single, lump-sum payment in one tax year following termination of employment, his income tax (assuming present rates, a joint return, and no other taxable income) would be about $6,218 if both he and his wife were age 65 or over. This leaves a net $41,200 of retirement income compared with Employee B's $30,639, or nearly a third again as much.

If, instead of a single sum of money, the two accumulations are converted to straight life annuities, Employee A's fund would buy about $4,500 of annual income, while Employee B's would buy about $2,900. Again, Employee A's $4,500 would be included in full in taxable income, while Employee B's would be includable only to the extent that it exceeded his investment in the contract. If the annuities received by the two employees are their only taxable income, Employee A would

pay approximately $240 a year in taxes while Employee B's deductions and exemptions would probably more than cover the "taxable" portion of his annuity. Expressed as a monthly retirement income for life, Employee A would receive $355 compared with Employee B's $240, or about a 50% higher monthly income.

The advantages of tax deferment to individuals is obvious from the above illustration. Yet the individual has little, if any control over whether his retirement savings are to be tax deferred or tax paid—except, of course, to seek a career with an employer who provides the advantage.

A Universal Approach?—It appears that universal coverage of workers under private retirement plans that will ensure a modest level of living in retirement is not likely to be achieved under the existing system of tax incentives for employer-sponsored retirement plans. To achieve this goal, we must look for avenues outside the employment relationship. We must seek some form of tax equality for individuals who work for corporations, for small employers, or for themselves.

If public policy recognizes the accumulation of retirement income through the employment relationship as a social aim worthy of encouragement by special tax treatment, is not the accumulation of retirement income outside the employer-employee relationship equally worthy? A program for extending an incentive for building retirement income through private sources should be based on the following characteristics.

1. Universality.—There must be one system that permits equal opportunity for all income producers to accumulate retirement income—whether they work for a corporation, a government entity, a not-for-profit institution, a sole proprietor, a partnership, an individual, or are self-employed.

2. Equality.—Because tax incentives produce a form of subsidy only for those who take advantage of them, they should be available to taxpayers on a relatively equal basis. Equality cannot be achieved through programs restricted to the employment mechanism where the individual worker is dependent on the actions of his employer to realize the full advantage of special tax treatment accorded deferred retirement income accumulations. Therefore, the incentive should be equalized through tax adjustments for the individual universally applied.

3. Simplicity.—Even if a suitable mechanism is available, its use may be severely limited unless the arrangement operates in a simple manner. The need for simplicity in turn requires a single measure of tax deferment.

4. Flexibility of Choice.—Any universal mechanism must have a structural flexibility to allow a variety of objectives of individuals in vastly differing circumstances to be met through a wide choice of methods and rates of individual savings. The greater the flexibility, the wider the appeal to the largest number of persons.

5. Economy.—Maximum incentive for private retirement income accumulation will result only from a program that permits personal retirement objectives to be met at the lowest possible cost in time and money.

If the objectives of maintaining private systems of retirement income are judged worthy of encouragement through tax incentives and if the characteristics outlined above appear to be appropriate

guidelines for achieving the objectives, it would seem that such an alternative source of old-age income should be thoroughly explored and appraised. There should be no hesitation about conducting such an exploration on the grounds that it represents a substantial departure from the present form of private retirement systems.

IV. An Alternative Approach to Old Age Income

The most obvious barriers to the maximum effectiveness of present tax policy as an incentive for the accumulation of retirement income are the absence of simple, economical arrangements for encouraging small employers to establish retirement plans and the absence of any incentive for individual saving for retirement outside of the employment relationship.

What course then might federal tax policy take to remove these barriers and encourage accumulation of retirement income? If tax incentives are considered a desirable method of encouraging private initiative to provide the funds required to support the aged sector of the population, the universal tax incentive described in broad terms below, may merit consideration by federal tax planners.

The philosophy underlying the universal tax incentive is simply this: that all workers should be provided comparable tax incentives to accumulate funds for retirement—whether the source of those funds is the taxpayer's employer, his own wage or salary, his earnings from self-employment, or any combination of sources. Such equity of tax treatment and incentive might be achieved through legislation that would need to be concerned with only three major points:

1. Calculation of the tax deduction;
2. Control of funds during the "holding" period; and
3. Payout of the funds.

Mechanics of the legislation might follow these general directions.

The tax deduction.—Permit each taxpayer to have a tax deferment of up to x% of his gross annual income, set aside for retirement, subject to some dollar maximum that would provide an appropriate level of living in retirement. Also, permit the taxpayer to save additional amounts to "catch up" for the past years of his working career when no deductions were available. Tax deferment for savings for the "catch up" years would be spread over the period remaining to retirement. The allowable tax deduction in any year would be the x% of his gross annual income used to purchase Retirement Certificates by the individual or his employer, or if larger, the amounts contributed to a qualified plan by the employee or his employer in his behalf for both current and past service. Any difference between the employer's contribution and the x% deduction could be taken by the taxpayer as a deduction from gross income in the current year.

The application of the allowable deduction could be effected solely through the individual's tax return. Supporting evidence would be coupons evidencing contributions for Retirement Certificates by the individual or by his employer. Contributions to a plan qualified under section 401, or tax exempt under section 403, of the Internal Revenue Code would be evidenced by a statement provided by the employer accompanying form 1099. This would report contributions by the employee and contributions by any employer to such plan used to

purchase individually identifiable retirement benefits, if any, or the actuarial value of retirement benefits earned by the individual, such value of benefits to be determined in accordance with standards to be established by the Internal Revenue Service as to the dollar value of benefits provided (e.g., six times the amount of benefits earned).

Control of funds.—A system for holding funds in an acceptable depository would be required. The prime concern would be assurance that the tax-free funds would remain on deposit until the individual's retirement. An appropriate vehicle, for example, other than devices presently defined by legislation, might be a series of Retirement Certificates, bearing a maturity date coinciding with the taxpayer's 60th birthday, issued as evidence of the taxpayer's bona fide retirement saving. Such certificates could represent actual investment in government obligations, common trust funds, insurance contracts mutual fund shares, or special funds created for the purpose by responsible fiduciary institutions. Government approval of the issuance of Retirement Certificates by any investment medium would be automatic approval of the investment by the taxpayer. The choice of investment would be at the option of the taxpayer, or his employer in the case of company contributions.

Payout of funds.—Funds would be paid out at any time after retirement at age 60 or later, or at the death of the taxpayer, but distribution should commence no later than age 70. Funds could also be released on proof of total and permanent disability, without adverse tax consequences.

Funds paid out on matured Retirement Certificates would be taxable as ordinary income when received. In the event of the death of the taxpayer, some form of "averaging" could be applied to reduce the tax impact on a large accumulation becoming payable in one year. Married couples could be permitted to own Retirement Certificates in joint tenancy with proceeds taxable as ordinary income until the death of the last surviving spouse. If Certificates were cashed before maturity (except in case of death or disability), a tax penalty would result.

Under the simplified type of legislation described above, a retirement accumulation plan could be initiated by either an individual or by an employer, or both, to the limit of each taxpayer's maximum allowable deduction. An arrangement of this kind would offer a number of advantages to employers, particularly small unincorporated employers. For example, it would:

1. Eliminate the necessity for the complicated machinery for "qualifying" a retirement plan since—
   - a. the question of "discrimination" is nonexistent if all taxpayers are permitted the same tax treatment for either employee or employer payments on an equal basis and
   - b. the system of Retirement Certificates would automatically guarantee compliance with the principles of present tax law regarding both insured and noninsured funds.
2. Simplify administration of the retirement program.
3. Justify retirement of unproductive older workers.
4. Promote the mobility of manpower.

Relationship to traditional "qualified" plans.—Such a retirement accumulation plan is not intended as a replacement for the qualified pension or profit sharing plan. Rather it is suggested as an extension of present tax policy to provide an incentive vehicle for the benefit of those millions of workers whose employment pattern is unlikely to ever produce retirement income coverage. Therefore, the small employer considering the adoption of a retirement plan should be aware that the advantages of such a retirement accumulation plan are offset by disadvantages, when compared with traditional qualified plans. Principally these are:

1. Employer contributions would have to be fully vested immediately, with the result that a disproportionate share of the employer's funds would be spent for employee retirement benefits for short-service, non-career workers.
2. The arrangement virtually precludes a fixed-benefit type of retirement plan—therefore the income produced for older employees during the early years of the plan might be inadequate to justify enforced retirement.
3. In the long run it may be a more costly method of providing retirement income than the qualified pension plan since investment gains and earnings would accrue to the employee, and there would be no offset for employee terminations.

Some of the effects that such a retirement accumulation plan would have on qualified plans include:

1. Some of the employee relations value of an employer-sponsored qualified plan might be dissipated if the employee could obtain the same tax advantage on his own accumulation plan. This effect would be partially offset to the extent that the employer contribution represented an increase in total compensation.
2. Vesting would become almost universal since employees would resist having their "deduction" in any other form. To avoid the administrative expense of immediate vesting for short-term employees, qualified plans would probably require a service eligibility period for participation.
3. Accelerated funding policies would almost surely result in view of the greater vesting of employee rights.
4. Encourage "portability," since the benefit of such a retirement accumulation plan is attached to the individual rather than to a job.

The principal advantages that the qualified retirement plan would retain over such a simpler form of retirement accumulation are these:

1. The employer could design his retirement income program to provide a fixed benefit in relation to the total period of service rendered by the employee, rather than in terms of a sum of money which might or might not provide the level of benefit in keeping with the employee's contribution to the business.
2. The benefit amount could be related to earnings during the final period of employment rather than to earnings during the actual years of participation.
3. There would be greater flexibility in funding benefits under either a traditional qualified pension or profit sharing plan than envisioned under such a retirement accumulation plan.

IMPLICATIONS OF A UNIVERSAL TAX INCENTIVE FOR PUBLIC POLICY

The desirability of adequate old-age income is a generally accepted fact. The question for public policy is whether an increase in the assurance of such income is worth the potential revenue loss, particularly in the early years of a tax incentive program. The aggregate amount of tax loss that might result from legislation authorizing universal tax incentive is difficult to anticipate since the loss would be dependent on the degree to which American workers are willing, or can be persuaded, to divert current income to long-term retirement saving. There is the added question whether such a tax incentive would encourage people to save more than they are already saving, or would it merely provide favorable tax treatment for present saving resulting from transfer from present forms to tax-favored forms at present rates of savings? Unless there is added saving, there is no increase in retirement income other than tax saving.

It is also important to emphasize the question this concept raises as to present inclusion in taxable income of the amounts that an employee contributes to social security or to a private retirement plan. At the present time all employee contributions are made from after-tax income. The benefits from social security and the employee's contributions to a private plan are returned to him as nontaxable income. An argument could be made that with, or without a universal tax incentive that reasonable accumulations for retirement by an individual should be made from before-tax income, with benefits received taxable as proposed herein for the retirement certificates. The adjustments in the tax impact on people with low retirement incomes would then be handled through special exemptions or other forms of tax treatment of income in old age. The only argument against this line of reasoning is, of course, the resulting reduction of current tax revenue.

This concept of the universal tax incentive is not an innovation in tax policy since in essence it represents the same concept that is expressed in the legislation dealing with the tax-sheltered annuity. If it is sound policy for this segment of the working population, it would appear to be equally applicable to a device made available to all workers who, for reasons in many cases similar to the reasons justifying the tax-sheltered annuity, should be permitted similar treatment. While broader in application, this concept is similar in justification to the Registered Retirement Savings Plan in Canada.

It is difficult to make even a rough estimate of the current tax revenue loss that might result from a universal tax incentive. Any estimate would have to include assumptions as to how many individuals would participate; the degree of participation (up to the maximum allowable or to some lesser degree); the level of participation (the earnings from which savings are made); and the effective tax rates on deferred saving.

The minimum tax loss that would occur is that resulting from deferment of income taxes on employee contributions to both private and public employee retirement systems (excluding OASDI and Railroad Retirement). In 1965 employees contributed just under $4 billion to such plans. If such contributions had been made from before-tax income, the revenue loss would have been in the neighborhood of $0.8

billion, assuming an average effective tax rate of 20% on amounts contributed.

The most likely area for additional revenue loss to occur from the operation of such retirement accumulations is the transfer of present savings to the tax-deferred status envisioned under the universal tax incentive. This is particularly true of those long-range savings of individuals that are earmarked for providing income in old age, with the exception of savings in the form of home ownership.

Present forms of savings most susceptible to transfer would probably include tax-exempt state and local government securities ($2.4 billion in 1965), U.S. Government savings bonds ($0.6 billion in 1965), savings shares ($9.3 billion in 1965), and investment company shares ($2.1 billion in 1965). This is not to imply that all, or even a substantial portion, of these forms of current saving would be deferred under retirement accumulation plans. The shorter-term forms of savings (such as time and demand bank deposits, preferred and common stocks, and other U.S. Government obligations) would be less likely to be transferred.

There is no question but that the universal tax incentive would have its greatest appeal to individuals in the higher tax brackets, both because of the greater effect on savings through tax deferment and the generally increased ability of such individuals to undertake long-term saving. This conclusion presumes that individuals are in high tax brackets due to any one, or a combination, of several circumstances, including: "high" income level, marital status, lack of deductions, and exemptions, and that each of these factors tends to effect simultaneously both the taxpayer's marginal tax rate and his financial ability to save.

The current revenue loss on amounts saved is not the sole consideration. A continuing revenue loss would occur on earnings of such retirement savings during the accumulation period. It should be noted, however, that the revenue "loss" would not include a loss resulting from fund earnings on present contributions by individuals to private and public employee retirement plans, since taxes are already deferred on such earnings. Nor would there be revenue "loss" resulting from earnings on savings diverted from U.S. Government savings bonds and tax-exempt securities of state and local governments, since taxes on savings bond earnings may be deferred until redemption and earnings of state and local government securities are tax-exempt.

The revenue losses that would occur because of tax deferment on contributions to such retirement savings arrangements and on the earnings during the accumulation period would, of course, be offset by increased tax revenues on funds released as retirement income. The effective tax rates of such future revenue recoveries may not be substantially lower than the rates at which the revenue losses occurred. Changes in marital status and deductions that tend to accompany the later years may have the effect of maintaining relatively stable effective tax rates, despite lower income. And the net difference in effective tax rates at time of loss and time of recovery may be less for high-bracket taxpayers due to the wider range of income taxed at specified rates, and to the fact that such individuals may have amassed substantial income-producing assets for use in their later years.

The effect of current revenue loss and the future offset by additional revenues can be illustrated by the tax consequences that might result from a given dollar amount of tax-deferred saving. For instance, if a taxpayer saves $1,000 annually for twenty years under the universal tax incentive described and if he earns 5% a year on his savings, the before-tax value of his accumulation after twenty years will be $33,065.95. But if $1,000 is "saved" each year by the same taxpayer under present tax rules, the federal government would collect a total of $5,306.60 during the twenty-year period, assuming effective tax rates of 20% on amounts saved and 10% on earnings. (A lower tax rate is assumed on earnings because investment income from various forms of long-term savings currently is not subject to the full impact of taxes, e.g., earnings on U.S. savings bonds and tax-exempt securities, and appreciation on equities.) This represents the "current revenue loss" that the federal government would incur on comparable savings under the universal tax incentive.

Under the universal tax incentive accumulation, however, the full amount of accumulated retirement savings would be taxable when received as retirement income. If a 10% effective tax rate is assumed (because of additional exemptions and reduced income) on funds received over a fifteen-year payout period, the probable tax recovery would amount to $4,652.51. This amount would reduce the earlier revenue loss to $654.09. However, additional tax revenue would be "lost" on earnings of the declining fund during the payout period of approximately $1,306.55, which would in turn increase the revenue loss during the combined periods of accumulation and payout to $1,960.64.

Under existing tax rules on personal saving, the value of the twenty-year accumulation described above would be $25,097.14. The difference between this amount and the $33,065.95 that would accumulate under a tax-deferred arrangement would produce total additional after-tax income of $7,631.25 over the fifteen-year payout period assumed. Thus each dollar of tax revenue lost by the federal treasury would generate an eventual $4.00 of retirement income.

The foregoing illustration makes no provision for interest on current revenue losses sustained by the Treasury Department, since it is assumed that such revenue losses would be replaced by additional revenue from other sources rather than by Treasury borrowing.

A universal tax incentive is not suggested as a perfect solution to the entire problem of assuring adequate income for the aged citizens of our nation—nor is it intended as a replacement for the existing forms of qualified pension and profit sharing plans and other tax-favored devices. It is offered instead as a stimulus to widen the horizon of thinking about old age financing.

CONCLUSIONS

The conclusion of the President's Committee on Corporate Pensions that "private pension plans should continue as a major element in the nation's total retirement security program" seems to reflect the majority opinion of people in government and industry. This review of the background, history, current status, and outlook for the future of the private retirement system appears to support this conclusion.

However, there is one deficiency of the private retirement system which will not be overcome by the processes and changes in the system that might develop through forced action, such as have been proposed, or through voluntary action, such as might come in the normal future development of the system. This deficiency is the apparent inability of the private system, as presently structured, to achieve universality of coverage.

Thus, in answer to the challenge of the Joint Economic Committee of the Congress of the United States to view these problems from a system-wide standpoint, it seems important to recognize this essential deficiency in the private system.

If "public policy should continue to provide appropriate incentives to private plan growth and by improving the basic soundness and equitable character of such plans set a firmer foundation for their future development," then it follows that devices which could correct this deficiency should be widely explored. There should be no reluctance to consider changes necessary to achieve the fulfillment of agreed-upon basic public policy.

It is toward this objective that the device described herein is suggested as an illustration of one alternative for consideration. It is interesting to note that such a basic change in the private system might in itself, by reason of its characteristics, effect many of the other changes proposed as necessary for improvement of the private system. The nature of a change, such as adoption of a universal tax incentive with the tax privilege related directly to the individual taxpayer rather than limited to application through the employer-employee relationship, would appear to lead to the natural achievement of the goals of portability, vesting, and adequate funding without the need for specific mandatory regulation of private plans to achieve this result.

While this is not intended to presume a final answer, it is hoped that it will sufficiently illustrate the possibility of extending the private retirement system to produce the characteristic of universality to warrant further exploration and consideration by those concerned with the determination of public policy for the entire area of retirement income.

The objectives of such efforts should be to develop a better way:

1. To encourage individuals to accumulate funds for their own retirement; to encourage employers to assist their employees to provide for their own retirement income; and to encourage employers to provide funds for their employees' retirement income.

2. To provide equity among all groups of taxpayers by extending to all the same opportunity to accumulate tax deferred retirement funds.

3. To preserve freedom of choice and action for individuals and employees in meeting their own needs and preferences in the provision of retirement income.

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