Public Employee Pension Systems Seen Short of Adequate Funding

State and local government units paid more than $9 billion into their employee pension systems in fiscal year 1975, an increase of 277 percent over annual costs a decade earlier. Despite this sharp rise in costs, there are growing indications they may be inadequate to meet the future benefit claims which some employees have been led to expect in their retirement years.

This clear warning emerges from a year-long study of more than 2,300 government pension systems just completed by Tax Foundation. The report, just published, shows that more than 9 million state and local government employees are covered. Receipts of all 2,304 systems in fiscal 1974 totaled $16.5 billion, almost five times the $3.4 billion reported for 1960. Of this amount, $4.2 billion was contributed by the workers, $4.5 billion came from earnings on investments, and $7.8 billion was contributed by the government employers.

Beneficiaries of the systems in fiscal 1972, the latest year for which overall figures are available, received $326 million a month, more than triple the amounts paid ten years earlier. Payments to all beneficiaries averaged $223 a month in 1972. Retired police and firemen average $315; teachers, $301. The amounts do not include Federal social security benefits. An estimated two-thirds of state-local employees are covered by social security in addition to their local retirement system.

"It is likely," says the report, "that pension plan coverage of state and local government workers is virtually universal."

This pattern is in sharp contrast to private industry where only about one-half of the workers are covered by retirement systems other than social security.

In addition, the report states, at least four-fifths of the state systems have provisions for increasing pension benefits after retirement. Formulas for determining pension benefits—typically the highest earnings during the last few years of employment—also push pension costs upward. Vesting provisions vary from none at all to immediate full vesting under which an employee is entitled to receive all retirement benefits which he has accrued if he leaves his job for any reason.

Benefit rates are almost always determined by multiplying a percentage of "final average salary" by the number of years of service but show wide variations as to age or age plus years of service.

The 80-page report, entitled "Employee Pension Systems in State and Local Government," makes it clear that in a great many cases the pension plans are:

- inadequately funded, or not funded at all;
- set up and administered in secret;
- over-generous in many of their provisions, and growing at a rate that will cost taxpayers unimaginnable new burdens in future years.
- And there are wide discrepancies among the hundreds of different plans.

A funded pension plan is one that has money paid in and invested, usually in bonds or other securities, the interest from which is to be used to pay the pensions.

Pensions in Massachusetts and a number of localities have no funding at all but are paid out of current revenues. The other 49 states and the majority of localities have plans that are funded to some degree but little or no information is made available to the public concerning the adequacy of funding.

In four of New York City's five pension systems it is estimated that additional payments of $300 million a year for the next 15 or 20 years would be required to put them on a sound financial footing. It was revealed recently that levels of funding in the city were based on actuarial assumptions made before World War I, more than 60 years ago.

Public employee pension systems in Atlanta and in 44 cities in Pennsylvania may be in similar danger of insolvency, the Tax Foundation study reveals.

Congress passed a law in 1974 called the Employee Retirement Income Security Act (ERISA). Its purpose is to regulate the private pension plans. Do (Continued on page 3)
Capital Formation: The Problem Remains

Tax Reforms Needed to Ensure Investment at 13% of GNP by 1980

New York—The capital needs of business for growth in the decade ahead and for providing new and productive jobs will require tripling today’s level of capital formation, according to Reginald H. Jones, chairman and chief executive officer of the General Electric Company.

Mr. Jones spoke at a meeting of Tax Foundation here on May 26. The meeting, attended by 130 members and trustees of the Foundation and their guests, is the third in the 1976 series of six planned membership meetings.

The capital requirements for this year and next will be met from current profits, Mr. Jones said. But the period to watch—and the time to prepare for—is the mature phase of recovery, say 1978 to 1980, when profits level off or even fall, but capital spending continues on new equipment.

“The capital formation problem has always been a long-term problem. We are dealing with something more than a cyclical swing. We are dealing with a long-run problem of underinvestment, a long-term deterioration of capacity to compete in world markets, and a long-term decline in our incentive to take risks, innovate and create new jobs for an expanding labor force.”

But in typical American fashion we say, “Why fix the roof when it isn’t raining?” Mr. Jones remarked.

In order to reduce the rate of unemployment to five percent by 1980, he said, “Business will have to invest 13% of GNP a year in 1977 through 1980.” According to GE economists, under the present tax laws we will be lucky to reach 10% of GNP in this period, because of inadequate funds and inadequate incentives to invest.

But corporate profits before taxes fell from 10.9 percent of GNP in 1965 to 8.0 percent in 1975. And, he added, “look what happens when you adjust for inflation. Removing phantom inventory profits and underdepreciation, we see that profits actually dropped from 11.2 percent in 1965 to 6.8 percent in 1975.

“Unless the tax laws are changed to provide the needed flow of funds, we can expect a revival of the same financial problems that ruined our balance sheets and aggravated both inflation and unemployment in the painful years just past,” Mr. Jones stated.

“The tax structure is pushing corporations into debt,” he emphasized. “As a result of the excessive debt, balance sheets place greater restraints on corporate investment.”

“To assure an adequate level of capital formation and job formation,” the GE chairman supports these tax proposals:

- Make permanent the 10 percent investment tax credit and the tax cut on the first $50,000 of corporate income to help small businesses.
- Legislate a capital cost recovery system to allow for depreciation and inflation.
- Integrate corporate and individual income taxes to eliminate the bias in favor of debt rather than new equity.
- Continue DISC funds as necessary working capital to stay in the export business.
- In the areas of capital cost recovery and the integration of corporate and individual taxes our principal foreign competitors are well ahead of us,” Mr. Jones pointed out. “There seems to be little recognition in the Congress of the importance of tax policy in keeping American industry competitive in the battle for exports and the related jobs here in the United States.”

Denouncing the pressure to pile more taxes on international companies, he said foreign affiliates of American companies account for about 50 percent of all U.S. exports of manufactured products. And exports, he continued, created 8,500,000 jobs in the U.S. Deducting 2,800,000 jobs presumed lost due to imports, we had a net employment gain of 5,700,000 jobs due to foreign transactions.

Nor are overseas investments a diversion of scarce capital from the U.S. After the initial investment, Mr. Jones explained, these foreign affiliates are financed largely by foreign funds. Returns from the leveraged investments, as they flow back to the United States, add more to our capital store than we paid out—a net inflow of $86.7 billion in 1975, he pointed out.

“It would surely be folly for the U.S. government to place its multinational companies at a further tax disadvantage in international competition for the sake of short-run revenue that would disappear as the golden goose dies.”

But the fundamental question, Mr. Jones concluded, is how we in the United States want to meet our needs for investment capital—by private or governmental means? By voluntary savings and investment, or by coercive taxation of the general public?

“Voluntary private investment, under a profit-and-loss discipline, has been the traditional and eminently (Continued on page 4)
To Provide More Jobs, We Must Balance Budget

The essential condition for creating productive new jobs is to bring the Federal budget at least to proximate balance by fiscal 1980. The way to do this is to hold the annual increase of Federal spending to a low rate, "certainly not much higher than what is proposed in the administration budget for fiscal 1977."

Professor Raymond J. Saulnier pursues this argument in Tax Foundation's current Tax Review all the way from Federal spending to deficits, to Treasury borrowing, to monetary policy, to interest rates and inflation, and to jobs.

His conclusion is that the only route to achieving the employment goals to which everyone subscribes is to move the Federal budget toward balance through a determined policy of expenditure restraint. This year's expected budget deficit of more than $70 billion is two and one-half times as large relative to GNP as the average deficit incurred in the years 1930 through 1974.

"It is difficult to persuade people it should be larger," says Dr. Saulnier. Proposals to increase Federal spending at a still faster rate and to run a still larger deficit have lost their earlier credibility. As a result most analysts have moved away from the standard approach to national economic management, which emphasizes manipulation of the Federal budget.

The proposed Federal budget deficit has caused Treasury financing to dominate credit markets, the professor notes. Treasury borrowing increased from 4 percent of all funds borrowed in 1973-1974 to 41 percent in 1975. Experience shows that even when private credit demands are depressed, a Federal deficit in the $75 billion range can be financed without sharply rising interest rates only when accompanied by a 9 to 10 percent increase in the broadly defined (M2) money supply.

"The rub is that a 9 to 10 percent increase in M2 virtually ordains inflation at 5 to 6 percent a year, and we know that 5 to 6 percent inflation is a serious block to the vigorous promotion of high and rising levels of employment," he writes.

If monetary authorities try to force a significantly lower money supply increase while Federal borrowing demands are high and private demands are rising, they risk causing interest rates to rise abruptly, with serious negative employment effects. But as budget balance is approached, Treasury credit demands recede, the economy's financing is accomplished with diminishing rates of money supply increase, the inflation problem lessens, and the more favorable credit markets encourage capital formation and the attendant increases in employment.

Raymond Saulnier is professor emeritus of economics at Columbia University and is a former chairman of the Council of Economic Advisers.

Tax Freedom Day Catches On In Press

Tax Freedom Day, May 1, 1976, reported by media from coast to coast, has become one of Tax Foundation's most successful public education efforts to date, according to Robert C. Brown, executive director.

Tax Freedom Day, announced in the April Tax Features, is the day the Foundation calculates the average taxpayer finally finished paying his 1976 taxes if he worked from Jan. 1. Clippings show that the story has already reached more than 33 million readers of 239 newspapers, nationwide. Radio coverage on Tax Freedom Day included all three major networks.

Excerpts from press coverage:

"The prestigious, independent Tax Foundation, Inc., founded in 1937 to promote better, more responsible (Continued on page 4)
Ad Council Offers Economic Booklet

The Advertising Council, Inc. has launched its $3 million campaign to bring basic economic education to the American people. The ads themselves will not educate but will offer a booklet called "The American Economic System." The booklet is offered free to anyone returning a coupon.

Ad headlines and themes are based on results of an in-depth survey conducted last year into basic attitudes about the economic facts of life. The Council's survey showed that knowledge of economics in the U.S. is abysmal.

The booklet covers the full gamut of economic issues, from "How It All Started" to our "Economic Choices" today. It discusses the impact as well as definition of consumers, producers, government, the law of supply and demand and the effect of competition. It tells why, for example, "In the years between 1955 and 1974 the ability of our dollar to purchase things went down by about 45 percent."

Companies wishing to obtain bulk quantities of this booklet for employers may order them from the Advertising Council, Inc. 825 Third Ave, New York, N.Y. 10022. Prices start at 11 cents for quantities up to 10,000.

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