MONTHLY TAX FEATURES

Tax Foundation, Inc.

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State and Local Retirement Funds Increased Six Times from 1960 Level

Assets held by state and local governments in support of employee retirement systems reached $111.5 billion at the end of fiscal year 1976, more than twice the amount held in 1970, and six times as much as in 1960, according to a Tax Foundation analysis. These holdings, in the form of cash and securities, totaled $18.5 billion in 1960 and $54.9 billion in 1970.

As assets have increased, investment earnings have represented a growing share of retirement system receipts. In fiscal 1976, earnings on investments, totaling $6.3 billion, made up 29 percent of the receipts of these pension systems, up from 25 percent in 1970 and 18 percent in 1960.

Although investment earnings have risen more rapidly than other sources of receipts, annual contributions of state and local government units continue to comprise the major source of income for the 2,300-odd state-local employee retirement systems in the nation. Government payments to the systems of $10.5 billion in 1976, although six times the 1960 amount, still represented the same portion (49 percent) of current income to the pension funds. In nearly all states, employees also contribute a percentage of their current salaries to pension funds, but employee amounts have been declining steadily in relation to total receipts--from 33 percent of the total in 1960 to 28 percent in 1970, and 22 percent in 1976.

There is wide variation in the financing of the state and local pension systems. The table (see page 4) shows state-by-state variations for fiscal 1976. The share of current receipts attributable to earnings on investments ranged from lows of 3 percent in Washington, D.C. and 15 percent in Delaware, Idaho, and Maine to highs of 45 percent in Nevada and 41 percent in Vermont. Employer contributions ranged from 21 percent in Nevada and 27 percent in New Hampshire to 76 percent in Washington, D.C. and 70 percent in Delaware. New York contributes 63 percent.

Assets and Annual Receipts of State and Local Employee Retirement Systems Selected Fiscal Years, 1960-1976 (Billions)

Year	Cash and security holdings[1]	Receipts, by source: Total	Employee contributions	Government contributions	Investment earnings
1960	$ 18.5	$ 3.4	$1.1	$ 1.7	$ .6
1965	31.8	5.3	1.6	2.4	1.2
1970	54.9	9.8	2.8	4.6	2.5
1975	98.1	18.9	4.5	9.1	5.3
1976	111.5	21.6	4.8	10.5	6.3

[1]As of end of fiscal year.

Source: Compiled by Tax Foundation from annual reports of the U.S. *Department of Commerce, Bureau of the Census.*

In part the rising share of investments in financing pension systems reflects the growth in assets of the systems, says the Tax Foundation, but the shift in the structure of portfolios over the past decade and a half has also played what is no doubt a significant role. Of the $111.5 billion in pension fund assets in 1976, nearly three-fourths was invested in corporate bonds and stocks, as compared with only about one-third in 1960. The 1976 portfolios reflected

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Rising Inflation Prompts Projections Of Future Prices

One pound of peanut butter: $11.23; one gallon of milk: $12.49; one pair of work pants: $80.69. Impossible? No, possible in the year 2021--45 years from now says the Federal Reserve Bank of St. Louis, if prices rise by five percent a year.

In an article entitled "So What, It's Only a Five Percent Inflation," the May 1977 issue of the bank letter warns of the dangers of accepting a five percent rate of inflation as a permanent fixture of our economy.

A person now earning $6,240 a year would be earning $56,077 a year in 45 years if his salary rose at five percent a year. But, whereas at $6,240 a year, this person would have received a $155 refund on Federal personal income taxes in 1976 as a result of the earned income credit, in 45 years he would have to pay $17,019.

His after-tax money income would thus rise from $6,395 in 1976 to $38,058 in 2021, or by less than the rate of inflation, leaving him with after-tax purchasing power of only $4,345 in constant 1976 dollars, a decline of nearly one-third.

The reason for this result is the progressive nature of the existing personal income tax structure in which taxes as a percent of income received rise from -2.5 percent to 30 percent.

Inquiries to TF

Inflation was the subject of a recent inquiry to Tax Foundation: A state

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Ten Percent of Taxpayers Paying Half of U.S. Tax Bill

Tax Foundation computations based on the recently released *Statistics of Income* of the Treasury Department show that 5 percent of the taxpayers—those with adjusted gross income of $29,272 or more—paid more than one-third of the total personal income taxes collected by the Federal government in 1975. The top 10 percent of taxpayers—those earning $23,420 or more—picked up the tab for nearly half the total tax bill.

Similarly, taxpayers with AGI of $15,898 or more, representing one-fourth of all taxpayers, footed 72 percent of total tax liabilities. In contrast, the lower 25 percent of taxpayers contributed less than 1 percent of total income taxes paid; the bottom 50 percent accounted for only 7 percent of tax collections.

Although much has been said about high-income taxpayers with little or no tax liability, the latest *Statistics of Income* showed that the 1,149 taxpayers earning $1,000,000 or more in 1975 paid an average tax of $1,011,317. The total tax paid by these few high-income taxpayers added up to $1.15 billion.

Moreover, as shown in the accompanying table, the relative share of the tax burden taken by upper income taxpayers has been increasing. For instance, the highest 10 percent paid 45.0 percent of total taxes in 1970 but their burden had increased to 48.7 percent by 1975. The share of the upper 25 percent went up from 68.3 percent in 1970 to 72.0 percent in 1975. At the same time, the small proportion paid by taxpayers in the lower income brackets shrunk to even smaller percentages over the 1970-1975 period. In addition, several million taxpayers disappeared from the tax rolls altogether as a result of legislative changes benefiting those with lower incomes during the period 1970-1975.

Adjusted gross income reported on all tax returns rose from $632 billion in 1970 to $948 billion in 1975, or 50 percent, according to Tax Foundation. During the same period the average tax per return increased from $1,415 to $2,020, or 43 percent. The difference between the change in AGI and average tax reflects primarily sharp increases in the amount claimed under the standard deduction—$32 billion in 1970 and $101 billion in 1975, a rise of over 200 percent. Itemized deductions at the same time increased from $88 billion to $122 billion, or 38 percent; personal exemptions rose 25 percent, from $128 billion to $159 billion.

Still other comparisons: total Federal individual income taxes paid increased from $84 billion in 1970 to $125 billion in 1975, or 49 percent, but the number on whom the burden of paying taxes fell increased only 5 percent, from 59 million to 62 million.

The *Mid-Session Review of the 1978 Budget* estimates individual income taxes at $158 billion in fiscal year 1977 and $178 billion in fiscal 1978.

Percent of Total Taxes Paid by High- and Low-Income Taxpayers 1970 and 1975

Adjusted gross income class	Income level 1970	Income level 1975	Percent of tax paid 1970	Percent of tax paid 1975
Highest 1 percent	$43,249 or more	$59,338 or more	17.6	18.7
Highest 5 percent	20,867 or more	29,272 or more	34.1	36.6
Highest 10 percent	16,965 or more	23,420 or more	45.0	48.7
Highest 25 percent	11,467 or more	15,898 or more	68.3	72.0
Highest 50 percent	6,919 or more	8,931 or more	89.7	92.9
Lowest 50 percent	6,918 or less	8,930 or less	10.3	7.1
Lowest 25 percent	3,157 or less	4,044 or less	.9	.4
Lowest 10 percent	1,259 or less	1,527 or less	.1	.1

Source: Tax Foundation computations are based on Internal Revenue Service, **Statistics of Income**.

Presidential Pay Agent Will Recommend Across-the-Board Federal Pay Increase

A 7.05 percent across-the-board pay increase for most Federal white-collar employees, estimated to cost up to $3.5 billion per year, will apparently be recommended to President Carter soon. The recommendation will come from the Director of the Office of Management and Budget, the Chairman of the U.S. Civil Service Commission, and the Secretary of Labor, acting jointly as the President's "pay agent."

Under a procedure first established by law in 1962, the salaries paid to Federal civil servants are adjusted annually (in October) to maintain rough "comparability" with private enterprise pay rates for the same kinds of work. Subsequently the procedure was accelerated and extended to provide comparable increases in the pay of military personnel. The increases recommended by the President's "pay agent" are based upon an annual *National Survey of Professional, Administrative, Technical, and Clerical Pay* conducted by the Bureau of Labor Statistics, Department of Labor.

The recommended increase, if approved by the President, becomes effective automatically (unless modified by action of the Congress). The President does have the option of proposing an alternative scheme—delay, reduction, or denial of the recommended

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About Tax Features

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'An Overgoverned Society' Is A Collection of 34 Essays

An Overgoverned Society (published by the Free Press, A Division of Macmillan Publishing Company, New York: 1976) is a collection of 34 essays by former Tax Foundation president W. Allen Wallis. Dr. Wallis is currently Chancellor and Professor of Economics at the University of Rochester. With wisdom and refreshing wit, the author presents basic issues of the utmost importance.

The broad variety of topics is roughly grouped into five headings: Policy, Goals, Prices, Growth, and Welfare. Although some selections were prepared originally for specialized groups or occasions, the substance has appeal and direct relevance to the lives of all Americans today. Throughout the book Professor Wallis' beliefs are clear and his warnings urgent: the lives of our children and our children's children will be affected—directly and far from beneficially—by increasing coercion of government.

As a distinguished economist, an authority on statistics, an active participant in many governmental commissions, a corporate board member, and university administrator, the author interprets events and processes—inflation, price control, automation, taxes, welfare programs—with deep insight, clarity, and force.

Selected quotations follow:

- Loss of confidence in government is easily explained by looking at the government's record in almost everything it promises, from delivering the mail to assuring adequate supplies of energy. (Page 8)

- My major theme has been that government power, however worthy the objectives for which it is established, inevitably forges fetters for freedom. (Page 10)

- Inflation can be generated only by the Government. Business firms, labor unions, or consumers with excessive market power can do many objectionable things that are contrary to the public interest; but one objectionable thing that they cannot do is to cause inflation—or, for that matter, prevent it. Within the Government the only important power to cause or prevent inflation lies with the Federal Reserve Board. If the Government has a large deficit, this will not cause inflation unless funds are supplied for financing the deficit.... (Pages 148-149)

- Growth is not an end in itself. We do not live to grow; we grow to live better. And we do live better, not only by consuming better but also by working under better conditions. Most of the brutal physical toil formerly necessary for man to make even a meager living has now disappeared. (Page 175)

The cover says: *TOP SECRET: Essential Government Economic Controls, Regulations & Guidelines,* by Robert A. Steiner (2nd Edition, Revised and Completely Updated. Enterprise Publishing Company: Wilmington, Delaware, 1977).

To quote the jacket copy:

In an analysis which has spanned more than two decades, the author has made a comprehensive study of government economic controls, regulations, and guidelines—past and present.

He has culled out those which he considers to be destructive, unnecessary, and/or harmful to the economy and citizens of the United States.

Detailed herein are all of the economic areas where he believes that it is proper for the mechanisms of government to intrude into the marketplace and to restrict voluntary free enterprise.

The pages, all 160 of them, are completely blank.

Federal Pay Increases...

(Continued from Page 2)

raise. Such an alternative, however, can be vetoed by a majority vote of either House of Congress, in which case the comparability adjustment originally proposed automatically takes effect.

Current reports indicate President Carter is likely to accept the recommendation for a 7.05 percent pay raise this October, even though it is more than half a percentage point higher than provided for in his budget, and would cost $250 million more. Last year Federal civilian and military personnel received an average 4.83 percent pay raise.

Since the new pay procedures were adopted in 1962, there have been 16 increases in basic and/or structural pay rates for Federal employees, according to the Tax Foundation. These adjustments—exclusive of any longevity increments—have raised average basic salary rates of civilian employees by 121 percent and military pay rates by 210 percent through October 1976. Federal payrolls are estimated at $68.2 billion in fiscal year 1977 and at more than $71 billion in 1978, according to the Foundation.

In 1976 Congress enacted legislation making its members, Federal judges, and top-level Executive Branch officials eligible to receive such annual comparability pay boosts. However, because of public criticism surrounding the substantial pay increase for those officials, which Congress allowed to become effective earlier this year, legislation recently enacted would deny the scheduled comparability raise this year only. The pay increases which became effective in February set salaries at $47,500 for those in the lowest level of the Executive Schedule, ranging upward to $57,500 for Members of Congress (higher for those in leadership posts) and most Federal judges, $70,000 for Associate Justices of the Supreme Court, and $75,000 for the Vice President, Speaker of the House of Representatives, and the Chief Justice of the Supreme Court. Those increases were based upon recommendations of a quadrennial Commission on Executive, Legislative, and Judicial Salaries.

In 1975, testifying before the President's Panel on Federal Compensation, Tax Foundation's Executive Vice President, Robert C. Brown, recommended that the pay comparability process be extended to apply to total compensation—pay and benefits—and urged that other improvements in the process be completed.

State and Local Funds...

(Continued from Page 1)

holdings of \$57.4 billion in corporate bonds and \$24.6 billion in stocks. Federal and state-local securities, which together had comprised more than half of total holdings in 1960, represented only 11 percent of holdings in 1976.

Despite apparent increases in "wealth," many state and local pension systems face precarious problems of future financing, according to a Tax Foundation study published in 1976 (*Employee Pension Systems in State and Local Government*, Research Publication No. 33). Among major sources of concern set forth in the study was the fact that government employer pension promises to future retirees are in many cases outrunning the resources being set aside to meet them. The costs of commitments for future pensions are rising rapidly because of growth in the number of state and local employees, rapidly rising salaries, and an increasing tendency on the part of state-local officials to grant more generous employee pension benefits.

Receipts of State and Local Employees' Retirement Systems by State
Fiscal Year 1976

	Amount (millions)				Percent of total		
State	Total Receipts	Employee Contributions	Government Contributions	Earnings on Investments	Employee Contributions	Government Contributions	Earnings on Investments
Alabama	\$ 290.2	\$ 69.0	\$ 147.4	\$ 73.9	24	51	25
Alaska	85.1	24.2	42.9	18.1	29	50	21
Arizona	186.6	54.4	73.1	59.1	29	39	32
Arkansas	117.5	33.1	54.8	29.6	28	47	25
California	3,535.7	879.1	1,607.1	1,049.5	25	45	30
Colorado	239.3	62.9	98.6	77.8	26	41	33
Connecticut	281.5	65.7	151.1	64.7	23	54	23
Delaware	46.9	7.0	32.9	7.0	15	70	15
District of Columbia	85.1	18.1	64.2	2.7	21	76	3
Florida	584.5	41.1	361.8	181.6	7	62	31
Georgia	311.3	85.3	143.5	82.4	27	46	27
Hawaii	157.6	45.9	52.2	59.5	29	33	38
Idaho	49.5	16.5	25.5	7.6	33	52	15
Illinois	1,200.2	388.3	507.7	304.2	32	42	26
Indiana	223.9	47.0	123.3	53.7	21	55	24
Iowa	151.7	40.8	54.6	56.3	27	36	37
Kansas	138.5	36.7	75.9	25.8	26	55	19
Kentucky	205.8	61.2	90.7	53.8	30	44	26
Louisiana	335.5	98.9	118.3	118.4	30	35	35
Maine	61.7	23.9	28.5	9.3	39	46	15
Maryland	386.3	111.7	160.6	114.1	29	42	29
Massachusetts	542.2	158.8	284.1	99.3	29	53	18
Michigan	975.1	163.8	516.5	294.8	17	53	30
Minnesota	362.6	104.0	187.0	71.6	29	51	20
Mississippi	127.0	41.0	52.0	33.9	32	41	27
Missouri	280.7	71.8	113.4	95.5	26	40	34
Montana	55.9	20.8	18.2	17.9	35	33	32
Nebraska	46.9	13.8	17.4	15.7	29	37	34
Nevada	58.9	20.2	12.0	26.7	34	21	45
New Hampshire	35.1	13.1	9.3	12.8	37	27	36
New Jersey	675.2	168.7	278.1	228.4	25	41	34
New Mexico	93.5	29.7	35.6	28.2	32	38	30
New York	3,802.4	215.6	2,410.6	1,176.3	6	63	31
North Carolina	422.7	110.3	170.1	142.3	26	40	34
North Dakota	17.8	6.9	7.1	3.8	39	40	21
Ohio	1,139.4	273.5	459.3	406.6	24	40	36
Oklahoma	125.7	26.4	69.4	29.8	21	55	24
Oregon	190.2	61.2	86.3	42.7	32	45	23
Pennsylvania	1,131.0	277.2	522.3	331.4	25	46	29
Rhode Island	76.3	21.7	34.0	20.6	28	45	27
South Carolina	188.6	57.0	81.5	50.1	30	43	27
South Dakota	37.6	12.5	15.8	9.3	33	42	25
Tennessee	265.1	64.6	134.8	65.8	24	51	25
Texas	809.1	242.9	351.6	214.6	30	43	27
Utah	83.4	29.5	32.8	21.1	35	40	25
Vermont	25.9	6.9	8.4	10.6	27	32	41
Virginia	252.1	98.0	79.2	74.9	39	31	30
Washington	475.2	152.8	200.2	122.2	32	42	26
West Virginia	132.3	33.1	73.8	25.4	25	56	19
Wisconsin	504.7	92.8	215.8	196.1	18	43	39
Wyoming	30.1	10.3	10.5	9.4	34	35	31
United States	21,637.0	4,808.3	10,501.8	6,327.0	22	49	29

Source: Compiled by Tax Foundation. Basic data from U.S. Department of Commerce, Bureau of the Census.

Inflation...

(Continued from Page 1)

employment services administrator, "was paid \$7,500 per year in 1939—tax free. State salaries were not subject to the Federal income tax. There was no state or city income tax as there are now. Assuming he had only two dependents—himself and his wife—what would his salary have to be currently, to yield the same purchasing power as in 1939?"

Tax Foundation responded as follows, assuming a 7 percent rate of inflation in 1977: The employee would have to earn \$44,245 in 1977, an increase of \$36,745, just to stay even, because of inflation and taxes:

	1939	1977
Salary	\$7,500	\$44,245
Federal income tax	—	9,018
Social Security tax	—	965
State income tax	—	710
City income tax	—	664
After-tax income	\$7,500	\$32,888
After-tax income in 1939 dollars	\$7,500	\$7,500

Tax Review Article

A final dramatic example of the effects of inflation under progressive taxation appears in the July 1977 issue of Tax Foundation's *Tax Review*. Professor Dan Throop Smith notes that, "A person paying an average income tax of 10 percent with a marginal rate of 20 percent can keep his real income constant if his before-tax income rises by 11 percent above the rate of inflation. One with an average tax of 30 percent and a marginal rate of 50 percent needs an increase in nominal income 40 percent above the rate of inflation. And someone with an average rate of 50 percent and a marginal rate of 70 percent needs a 67 percent increase in income above the rate of inflation to keep even with inflation."

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