

MONTHLY TAX FEATURES



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Federal Pensions—Up, Up and Away!

Benefits and Beneficiaries under Federal Employee Retirement Systems^a
Selected Calendar Years, 1955-1975

Year	Benefits (millions)	Beneficiaries ^b (thousands)	Average benefit per employee annuitant ^c
1955	\$ 868	490	\$1,957
1960	1,596	788	2,322
1965	2,945	1,231	2,714
1970	6,075	1,759	3,861
1975	14,595	2,480	6,544
Percent increase over previous period			
1955-60	84	61	19
1960-65	85	56	17
1965-70	106	43	42
1970-75	140	41	69

a. Includes benefits to employees for age, service, and disability; and benefits to survivors.
b. As of June 30.
c. Excludes survivor benefits.

Source: Office of Research and Statistics, Social Security Administration, U.S. Department of Health, Education, and Welfare; and Tax Foundation computations.

Military Retirement Presents Many Special Cost Problems

Military pensions present a special set of problems in any assessment of Federal retirement practices according to a Tax Foundation study, "Federal Employee Retirement Systems." There are 2.1 million servicemen, 873,000 reservists, and 1.2 million retirees on the Pentagon's payroll, all covered by a pension system administered by the Department of Defense.

While there is growing recognition that military pension costs are high,

there is still little public awareness of just how high the costs are, according to the Tax Foundation analysis.

The Federal budget for fiscal year 1979 puts military pension outlays at \$10.2 billion. But, says the Foundation, the true costs are 70 percent higher—or over \$17 billion.

Why this vast difference? Federal budget reporting practices obscure the true cost of military pensions. The
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Federal pension costs continue to grow at a rapid rate, presenting the American taxpayer each year with an ever-larger tax bill, reveals a new Tax Foundation report, "Federal Employee Retirement Systems." Total benefits paid under Federal retirement programs, the number of beneficiaries, and the average benefit paid per person have risen sharply since 1965. (See accompanying table.)

Retirement benefits under Federal systems were five times as large in 1975 as they were a decade earlier, for a total of \$15 billion. Benefits for 1978 were estimated at over \$20 billion.

Payments have grown rapidly in absolute terms. They have also mounted in relation to the direct pay of Federal employees, according to the Tax Foundation. In 1968, retirement payments represented about 10 cents per dollar of payrolls. Today, they equal 28 cents per payroll dollar.

The Federal government is a major employer and operates more than a dozen retirements systems with a total membership of five million and employee and survivor annuitants of about 2.5 million persons.

However, the Civil Service Retirement System and the Uniformed Services Retirement System represent almost 99 percent of benefit payments.

Military Pensions

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\$10.2 billion figure reported as the amount of the pension bill is for past services only. The money goes entirely to those already retired. The budget does not take account of the ultimate costs of future retirement benefits which accrue each year on behalf of present military personnel. For 1979, the annual cost of these future benefits is estimated at \$7 billion.

Because no funds are set aside to meet future military pensions, the Federal government's liability for such claims will have accumulated to \$197 billion in 1978 and is projected to rise to \$276 billion by 1983, according to the new Tax Foundation study. The military pension system is not funded but is on a pay-as-you-go basis. All of the liability is unfunded.

Various official studies in the past have recommended that defense budgeting practices be changed so as to reflect more accurately the true costs of military pensions. The latest of such recommendations comes from the President's proposed budget for 1979, which calls for financing military retirement costs on an accrual basis, and setting up a trust fund with annual appropriations to gradually eliminate the present unfunded liability.

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Military pensions, considered extremely generous and rated as very costly, represent a large portion of the defense budget. Manpower outlays for civilian and military personnel of the DOD, including pensions and disability, increased from 42 percent of the budget in fiscal 1968 to 57 percent in 1977. This occurred *despite* an overall reduction of 37 percent in personnel during that period.

Such costs raise questions about whether the nation can afford to pay its defenders so well and still continue to defend itself. President Jimmie Carter recently remarked:

Under present circumstances, by the end of this century, our ability to defend our Nation might very well be sapped away by excessive personnel costs.

Gov't Workers Enjoy Rare Pension Fringe

Retirees from government service, civilian and military, enjoy a fringe benefit rare among American workers. Their pensions contain an automatic cost-of-living adjustment, according to "Federal Employee Retirement Systems," a new study from the Tax Foundation.

Enacted into law in 1962, these post-retirement pension increases were originally pegged to the Consumer Price Index (CPI) on an annual basis. Whenever the Index increased by at least 3 percent in a year, military and Civil Service pensions would go up correspondingly.

When consumer prices rose too slowly to automatically trigger increases, Congress passed legislation in 1965 to give civilian and military annuitants a one-time increase. Additional legislation geared the cost-of-living principle to a more sensitive monthly price index indicator: Whenever the CPI rose by 3 percent over the base month for three consecutive months, retired pay would

Disabled Workers' Cost Is Considered Too High

For every four Federal employees who retire because of age or service one retires because of disability, according to a new Tax Foundation study, "Federal Employee Retirement Systems."

As of 1975, the latest year reported, some 421 thousand persons received disability payments under Federal employee retirement systems. Total benefits came to over \$2.2 billion, nearly four times as much as in 1965, the Tax Foundation study revealed.

Skyrocketing benefits were most prevalent in the Civil Service System, which accounts for about 60 percent of all disability payments. From 1965 to 1975, the number of disabled Civil Service retirees jumped 73 percent, from 149 thousand to 258 thousand. During the same period, benefits actually paid almost quintupled, from \$279 million to \$1.3 billion.

Some of the reasons for this sharp growth were pinpointed in the Tax Foundation study:

1. Many retirees are able to do other government work, but retirement

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be increased by the highest percentage rise in the CPI in any of the three months.

The cost-of-living boost was further liberalized in 1969 when Congress passed the so-called 1-percent "kicker." Retirement annuities were raised by 1 percentage point more than the rise in the CPI whenever an increase was granted.

After a few years, the Tax Foundation study points out, it became clear that the 1-percent increase overcompensated retirees. Between November, 1969, and March, 1976, ten increases in benefits were made, raising the average annuity by 72 percent.

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Pensions Not Counted In Gauging Comparability Of Federal Pay

Based on 20 working years, and excluding any cost-of-living benefits and all fringe benefits, a lifetime enlisted military retiree receives a pension estimated at 132 percent of salary, according to "Federal Employee Retirement Systems," a new study from the Tax Foundation. By contrast, a Federal civil servant's pension amounts to 49 percent, state and local government retirees receive 47 percent, and private sector pensions come to about 20 to 30 percent of lifetime salary.

The gap between military and private-sector pensions is enormous, Tax Foundation research shows. And

the need to bring pay, benefits and pensions into line with compensation prevailing elsewhere in the economy pervades the Federal system.

In 1962, Congress acted to make the pay of government workers comparable to salary and wage levels existing in private industry. This was designed to enable the Federal government to compete fairly in the job market and to provide a logical basis for determining government pay scales. Pensions, however, were left out of the plan. They are still excluded, even though they represent a growing percentage of the total Federal employment compensation package.

Comparison of Selected Characteristics of Retirement Systems for the Uniformed Services, Federal Civil Service, State-Local Governments, and the Private Sector

Characteristic	Retirement system			
	Uniformed services	Federal Civil Service	State-local governments	Private sector
Persons with normal retirement below age 65 ^a	100%	100%	70%	5%
Persons under age 50 eligible to receive a pension	All	A few	A few	Virtually none
Average pension as percentage of "final salary" after 30 years of service	59% Enlisted ^b 62% Officer ^b	56%	50%	40%
"Final salary" defined as average of	Final paycheck	High-3 years	High-5 years	High-5 years
Pension as percentage of final paycheck	59% Enlisted ^b 62% Officer ^b	51%	44%	35%
Frequency that pensions reduced by some part of social security payment	None	None	1/3	2/3
Workers covered by automatic cost-of-living clauses	100%	100%	50%	2 1/2 %
Proportion of inflation in last 5 years covered by cost-of-living raises (for those so protected)	More than 100%	More than 100%	Unknown	25%
Proportion of workers required to contribute to fund pension plan	0%	100%	94%	25%
Fringe benefits for retirees	Many	Rare	Rare	Rare
Vesting (years required)	20	5	10	10

a. Early optional or involuntary retirement is available at any age with 25 years of service.

b. The pension after 30 years service is equal to 75 percent of basic pay. These percentages compare pensions with regular military compensation, e.g., the sum of base pay, the quarters and food allowances, and the tax advantage that accrues because the allowances are tax exempt.

Source: Les Aspin, *Guns or Pensions. A Study of the Military Retired Pay System*, Washington, D.C., November 1976, p. 4.

Also Available

The following Tax Foundation publications are also available:

- "Taxing Foreign Source Income: A Businessman's View," Government Finance Brief 27, by B. Kenneth Sanden. 16 pages. \$1.

- "Corporate Tax Integration: A Quantitative Comparison of Alternatives," Government Finance Brief 28, by Martin Feldstein and Daniel Frisch. 28 pages. \$1.

- "The Federal Budget for Fiscal Year 1979, No. 1—Highlights and Summary." 12 pages. Free.

Pension Estimates Considered Too Low

The "official" estimate of liabilities of the Civil Service Pension system greatly understates the true obligations of the system, according to Tax Foundation's newly published "Federal Employee Retirement Systems." Despite additional funding begun in 1971, the Civil Service Commission figures indicate that the unfunded liability of the System shot up 82 percent from 1971 to 1976 to a total of \$107 billion.

Even these figures vastly underestimate the true obligations of the system, says the study. Current methods of determining unfunded liabilities make no provision for the future impact of inflation on either salaries or annuities.

The Civil Service Commission maintains that it is simply obeying the law with its reporting methods. Critics charge that present procedures give a misleading impression that Federal pension costs are much lower than is actually the case. Using a different set of assumptions, the Board of Actuaries of the System calculated that the true unfunded liability of the Civil Service pension system, as of 1972, was more than twice the officially published figure.

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Social Security—Boon and Bane for Federal Job Benefits Package

The relationship between Federal employees and the Social Security system is, at best, schizophrenic, according to information contained in a new Tax Foundation study, "Federal Employee Retirement Systems." Civil servants are excluded by law. The military has been included since 1957, but critics consider the terms of inclusion too generous.

Civilians

Repeated studies and legislative proposals have called for including Federal civilian employees under the Social Security system, Tax Foundation points out, but no progress has been made toward this goal.

Two major problems result from their exclusion:

1. Some civil servants have gaps in their coverage. Thousands of employees leave government service each year, but only a small fraction ever receive Federal retirement benefits. Career civil servants have no retirement or disability coverage during their first five years. Disability for those who do qualify lapses if they leave Federal

Pension Fringe

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During the same period, the CPI rose only 56 percent.

The "kicker" also raised unfunded liability in the Civil Service pension system by some \$5 billion during the 1969-1976 period. In 1976, both the President's Budget and the GAO recommended elimination of the increment.

Congress reacted to these recommendations and to widespread public criticism by repealing the "kicker" and providing for an automatic cost-of-living adjustment scheduled twice a year, on March 1 and September 1. The first increase under the new provisions, amounting to 4.8 percent, took place March 1, 1977.

employment before retirement. It generally takes longer for government workers to achieve family survivor benefits than it does for those under Social Security. Disability payments to government employees with dependents are, in many cases, lower than those prevailing under Social Security.

2. Other ex-civil servants enter the Social Security system relatively late and receive an unfair advantage over workers who have contributed during their entire working lives. These "Johnnies-come-lately" receive high benefits relative to Social Security taxes paid because their earnings base is relatively low. Other workers and their employers must bear the cost of such windfall benefits.

Despite these arguments for inclusion, Federal Civil Service organization leaders have consistently maintained their opposition to bringing Federal civilian workers under the Social Security system, according to the Tax Foundation.

Military Personnel

The military, by contrast, seems to gain too much from Social Security coverage. Benefits for military personnel are the same as for other persons covered by Social Security and are tax exempt. Qualification standards are also the same. There the similarities end.

Military retirees do not have their Social Security annuities integrated with or offset against staff retirement payments. Benefits under the one system are not reduced because of inclusion in the other. This puts military retirees in an advantageous position compared to private sector workers and many employees of local and state government. This disparity is among those being currently studied with a view to restructuring the military's retirement compensation system. (See article on Military Pensions in this issue of *Monthly Tax Features*.)

Disability Costs

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provisions actually work against a retiree's continuing elsewhere in the Federal system. To be classed as "disabled," a Civil Service employee need only be unable to perform some part of the duties assigned his job classification. He cannot be required to transfer to another Federal job which is within his capability.

2. General Accounting Office (GAO) studies indicate that the Civil Service Commission may be too lax in granting disability retirements and in keeping retirees on the disability rolls. In 1975, the Commission approved 95 percent of the applications it received.

3. Many retirees with disability status find employment outside the Federal government.

The GAO has recommended that Congress revise Civil Service disability provisions to remedy these and other defects and to insure that only those entitled to benefits receive them.

Low Estimates

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One major negative result of these reporting defects, the Tax Foundation's study points out, is that the apparent low level of Federal pension benefits may encourage the government to grant ever increasing open-ended commitments to up-grade benefits. These can only lead to a crushing future financial burden for the taxpayer.

This issue of *Monthly Tax Features* is based on Tax Foundation, Inc.'s Research Publication No. 34, "Federal Employee Retirement Systems." A "Summary" of the study is available without charge from Tax Foundation, 50 Rockefeller Plaza, New York, NY 10020. The complete RP 34 is available from the Foundation at \$3.00.