

# MONTHLY TAX FEATURES



**Tax Foundation, Inc.**

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## 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

### Study Shows 2,304 State, Local Plans Have Many Problems

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 unimaginable 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

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# 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



Reginald H. Jones

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 business.
- 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.

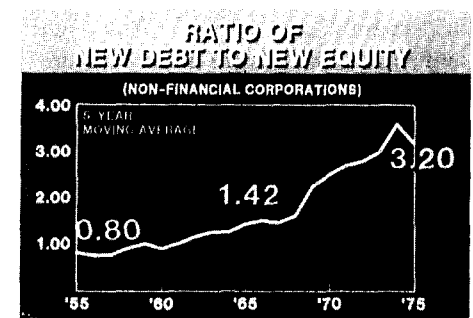
Nor are overseas investments a diversion of scarce capital from the U.S. After the initial investment, Mr. Jones explained, these foreign affiliates are financed largely by foreign funds. Returns from the leveraged investments, as they flow back to the United States, add more to our capital store than we paid out—a net inflow of \$6.7 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

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## "Pensions"

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public pension plans also need attention, as the law requires, the report asks.

Copies of the full text of the report are available from Tax Foundation at \$3.

**Average Monthly Benefits Paid  
By State and Local Pension Plans,  
Percent Covered by Social Security**

State	Monthly Benefits <sup>1</sup> Fiscal Years		Also Have Social Security <sup>2</sup>
	1962	1972	
Alabama .....	\$ 80	\$187	66
Alaska .....	148	195	54
Arizona .....	83	100	83
Arkansas .....	119	143	70
California .....	209	278	54
Colorado .....	144	214	19
Connecticut ..	144	259	51
Delaware .....	135	385	75
District of Columbia ..	282	547	11
Florida .....	138	241	69
Georgia .....	133	214	64
Hawaii .....	144	230	89
Idaho .....	87	138	78
Illinois .....	130	211	25
Indiana .....	132	195	67
Iowa .....	31	63	76
Kansas .....	87	80	69
Kentucky .....	92	182	50
Louisiana .....	133	299	27
Maine .....	93	216	23
Maryland .....	152	90	77
Massachusetts	163	273	6
Michigan .....	134	224	74
Minnesota .....	128	156	63
Mississippi ..	50	120	66
Missouri .....	82	138	61
Montana .....	103	240	77
Nebraska .....	79	102	71
Nevada .....	140	294	2
New Hampshire ..	91	157	69
New Jersey ...	152	NA	59
New Mexico ...	129	207	59
New York .....	162	300	76
North Carolina	80	162	66
North Dakota ..	82	116	72
Ohio .....	134	207	3
Oklahoma .....	50	187	72
Oregon .....	70	92	81
Pennsylvania ..	151	275	67
Rhode Island ..	149	278	49
South Carolina	68	131	77
South Dakota ..	73	43	70
Tennessee ...	87	142	64
Texas .....	111	193	51
Utah .....	79	103	77
Vermont .....	97	155	59
Virginia .....	84	158	75
Washington ...	108	189	77
West Virginia ..	98	226	75
Wisconsin .....	83	126	75
Wyoming .....	59	66	79
All states .....	137	223	58

<sup>1</sup> Covers persons retired because of age or length of service; on account of disability; and survivors of former system members.

<sup>2</sup> Full-time state and local employees, as of 1972. Source: U.S. Department of Commerce, Bureau of the Census.

# 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 de-

mands 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 follow:

"The prestigious, independent Tax Foundation, Inc., founded in 1937 to promote better, more responsible

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## 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.

# Nancy Hayward Resumes Discussion Of Productivity in Public Sector

Public officials at all levels of government share a sense of urgency about the need to improve the productivity of their services, Nancy Hayward told delegates to the April National Taxpayer's Conference in Washington D.C.

## "Capital"

(Continued from page 2)

successful approach in the United States.

"It is important that we preserve the voluntary, private enterprise approach to the generation and allocation of capital. Having seen what happens to economic progress and human liberty wherever socialism has been tried, I think most Americans would heartily agree."

## "Tax Freedom"

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government, recently estimated that the wage earner spends the first two hours and 39 minutes of each and every day working to pay his state and federal taxes."... The Hartford Times. "The Tax Foundation notes sadly that Tax Freedom Day was celebrated last year on April 28," said the San Antonio Light... "It's no wonder the middle class comes into this election year with a grudge against government," said the Dallas Morning News... "The average taxpayer this year, will in effect, be working for the government until May 1," said the Chicago Daily News. "It will take until that date to earn the money Uncle Sam and his nieces and nephews in state and local government will spend"... "Taxes," said a Washington Star story, is now "the largest item in the average family budget"... "Ever vigilant and hopeful despite some stunning statistical reverses, the economy-minded Tax Foundation forever tries to correct that situation by reducing—a questionable phrase—tax figures to something meaningful. To wit: the average taxpayer this year will, in effect, be working for the government until May 1."—John Cunniff, Associated Press.

Ms. Hayward, the energetic director of public sector programs at the National Center for Productivity and Quality of Working Life, provided some answers to the perplexing question: Why is there so little improvement in the output of government services?

Ms. Hayward later briefed Tax Foundation on her organization's current study into these pressing issues.

The public sector spokesperson explained to the gathering at the 34th annual conference that productivity is a long-term issue, but elected officials are geared to their term of office. Doing things quickly costs money.

Productivity also requires start-up costs, she said. But public employee costs alone have gone up 152 percent in the past 20 years.

In addition, attempting to define resources earmarked for the Federal government and those for state and local government complicates and hinders progress toward greater productivity, she told the delegates from 22 states.

These impending issues have propelled the private Washington D.C. organization to spell out and study five areas of concern with productivity in government, especially on the state and local level.

Areas to be scrutinized are: general management competence; labor-management relations; economic and fiscal health of state and local governments; federal support for improvement of managerial capabilities; and an improved mechanism for overseeing regulations imposed not only on private enterprise but also on state and local governments.

A discussion of these issues will be published this summer by the committee.