EXTENDING PRIVATE PENSION COVERAGE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON EMPLOYMENT AND RETIREMENT INCOMES

OF THE

SPECIAL COMMITTEE ON AGING UNITED STATES SENATE

EIGHTY-NINTH CONGRESS

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EXTENDING PRIVATE PENSION COVERAGE

THURSDAY, MARCH 4, 1965

U.S. SENATE,
SUBCOMMITTEE ON EMPLOYMENT AND
RETIREMENT INCOMES OF THE
SPECIAL COMMITTEE ON AGING,
Washington, D.C.

The subcommittee met at 10:15 a.m., pursuant to call, in the New Senate Office Building, Washington, D.C., Senator Jennings Randolph (chairman of the subcommittee) presiding.

Present: Senators Randolph, Moss, and Fong.

Also present: Senator Morse.

Committee staff members present: Messrs. J. William Norman, Jr., staff director and John Guy Miller, minority staff director.

OPENING STATEMENT OF THE CHAIRMAN

Senator RANDOLPH. Good morning. Our hearing will begin. During these hearings this subcommittee will explore possibilities for extending private pension plan coverage. Private pension plans are making an important contribution to retirement incomes of America's senior citizens. Such plans pay almost \$2¾ billion a year in benefits to nearly 2½ million beneficiaries.

However, significant as this source of income is, it represents only a minor fraction of total incomes received by America's elderly, and recipients of these benefits constitute only a small percentage of the 18 million Americans over 65.

Thus, it appears that through wise Federal statutes, administrative actions, and policies regarding private pension plans, the Government can encourage improved and expanded coverage for millions of older Americans. In this way, significant additional financial resources could be made available to sustain our Nation's elderly in retirement.

Even under present procedures, it is estimated that the next 15 years will bring a substantial increase in the number of pension recipients, in the number covered, and in the total of private pension dollars disbursed.

The President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, in its recent report, estimated that by 1980 the number of employees covered will increase from the present 25 million—50 percent of the nonagricultural work force—to 42 million—60 percent of the work force.

That group also indicated that the number of beneficiaries will increase from 2½ to 6½ million, while benefit payments will rise from the present \$2¾ billion per annum to \$9 billion per annum.

Impressive as these totals are, it must be borne in mind that they indicate that at the end of the next 15 years, 40 percent of the nonagricultural work force will be without private pension coverage. Less than half of those persons over 65 in 1980 will actually be receiving private pension benefits.

And I am very happy that Senator Morse is present this morning as we begin these hearings. I know of his busy schedule and I know that he will be here as much as possible. We had earlier today prior to the opening of the hearing Senator Carlson of the minority who indicated his very real interest and he hoped to be able to participate in later sessions of the subcommittee.

In these hearings, the subcommittee hopes to identify those persons who comprise the 50 percent not now under private pension coverage and the 40 percent who are not expected to be covered in 1980.

We will receive recommendations from organizations of employers and workers, Government departments and agencies, and others knowledgeable in this field. We solicit comments as to what Federal laws, administrative actions, and policies could result in improved coverage for the maximum number of this hard-to-cover 40 percent.

One aspect of this inquiry concerns the extent of coverage of the self-employed and their employees in the smaller business and professional units.

A friend of mine who is an attorney told me last evening that the fact that the Smathers-Keogh law, H.R. 10, has the $2,500 limitation means that really the law is inoperative. He indicated that attorneys are not being covered and that he feels that some studies should be given to that statute.

I have not had an opportunity, Senator Morse, to discuss it with you or other members of the subcommittee. I had not thought of it in the way that he explained it to me.

The subcommittee will welcome testimony on the effect of the Self-Employed Individuals Tax Retirement Act of 1962—H.R. 10—in bringing such individuals under private pension coverage, and what, if any, amendments to that act are needed to make it a more effective stimulant of private pension coverage.

There were two recommendations in the report of the President's Committee which this subcommittee would wish to explore from the standpoint of their effect upon extending coverage.

The first is the recommendation to eliminate the option which qualified retirement plans now have to cover only salaried or clerical employees, unless there is a showing of special circumstances.

The second is to reduce from 5 years to 3 the maximum period for which coverage of any employee can be deferred by qualified plans.

I am hopeful that these hearings will help to create wider understanding of the needs of both the employer and employee with respect to extending private pension plan coverage. Throughout, our goal will remain the building of a better life for older Americans.

At this time I would like to place in the record a copy of the 18 questions which we sent to the witnesses asking them for their comments and recommendations.

(The questions referred to follow:)

(1) Is it a wise and proper activity of the Federal Government to encourage the extension of private pension coverage to more of its citizens and to seek to increase the amount of private pension income received in retirement?

(2) What advantage do private pensions offer from the standpoint of the employee? The employer? The Federal Government?

(3) What is the annual loss resulting from present favored tax status of private pensions?

(4) Is the revenue loss more in the nature of a "tax loophole" which permits some to avoid paying their fair share of taxes, or is it more in the nature of a sound investment in the future retirement incomes of our senior citizens and in the future economic stability and prosperity of Americans of all ages?

(5) To what extent is the revenue loss offset by decreased Federal expenditures such as those for public assistance?

(6) It was estimated in the report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs that approximately 50 percent of the nonagricultural work force is not covered by private pension plans. Who are the workers who are not covered?

(7) The report estimated that in 1980, two-fifths of the nonagricultural work force will not be covered. Which workers will be without coverage?

(8) What Federal statutes, regulations, and administrative actions and policies would contribute to the extension of private pension coverage at reasonable Federal costs?

(9) What are the special problems of extending coverage to farmers and their employees or coworkers, and is any Federal action with reference to such coverage feasible?

(10) To what extent has advantage been taken of the Self-Employed Individuals Tax Retirement Act of 1962 (H.R. 10) in extending private pension coverage?

(11) To what extent have taxpayers purchased the special bonds provided by that act for establishing pensions?

(12) What is the estimated annual loss of revenue resulting from that act?

(13) What amendments to that act would make it a more effective stimulant to extension of private pension coverage?

(14) What would be the effect upon the extent of private pension plan coverage of requiring that professional service corporations and associations be recognized and taxed as corporations by the Internal Revenue Service?

(15) What would be the effect upon extent of private pension plan coverage of the recommendation of the President's Committee that the option which qualified retirement plans now have to cover only salaried or clerical employees be eliminated, unless there is a showing of special circumstances?

(16) What would be the effect on extension of coverage of that Committee's recommendation that the maximum period for which coverage of any employee can be deferred by qualified plans be reduced from 5 to 3 years?

(17) What would be the Federal cost of actions recommended in answer to questions 8, 13, 14, 15, and 16 in terms of revenue losses and other costs?

(18) Would the benefits resulting from such actions be worth this Federal cost?

Senator RANDOLPH. Senator Morse, would you wish to make a comment before our first witness is called?

Senator MORSE. I will say, "Amen," to what you said.

Senator RANDOLPH. Thank you, Senator Morse.

We will have the opportunity now of receiving the valuable testimony of Dr. Ida C. Merriam.

STATEMENT OF DR. IDA C. MERRIAM, DIRECTOR OF THE DIVISION OF RESEARCH AND STATISTICS, SOCIAL SECURITY ADMINISTRATION, REPRESENTING U.S. DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Senator RANDOLPH. Dr. Merriam, you will, of course, identify yourself to the subcommittee for the record. Your statement can be read if you desire or we will consider it as read and it will be made a part of the record.

It might be easier for you and more helpful to the subcommittee if you just discuss certain portions of your statement. But we will leave that to your judgment.

Dr. MERRIAM. Thank you, Mr. Chairman. I am Ida Merriam, Director of Research and Statistics for the Social Security Administration in the Department of Health, Education, and Welfare.

While I am honored to represent the Department here, I would also, Mr. Chairman, like to express to you the regrets of Mr. Robert Ball, Commissioner of Social Security, that because of a previous appointment with the Ways and Means Committee he was not able to be here himself.

It has seemed to us that before one can discuss the current status of private retirement plans and improvements that can be sought in such plans, one must take a look at the entire network of income-maintenance programs that has developed in this country to assure a continuing money income for older people who no longer have income from work.

The basic program of old-age security in this country is the Federal old-age, survivors, and disability insurance—OASDI—system. Its key role arises first from its almost universal coverage. More than 9 out of 10 people in paid employment and self-employment are covered or eligible for coverage under the program. This universal coverage assures workers that their OASDI coverage will follow them whenever they shift from one job to another.

The value of this continuous coverage is reflected in the fact that 91 percent of the persons now turning age 65 are estimated to be eligible for monthly benefits under the program. Eventually, about 95 percent of all persons past 65 will be eligible for benefits.

Another key feature of the OASDI system is the complete portability of credits earned and the security of its financial arrangements. Earnings with different employers and in different types of employment are combined and given full credit toward the computation of an individual's retirement benefits. The capacity to finance benefits rests on the entire economy rather than on a single firm or industry.

A third key feature is the broad scope of benefit protection. In addition to retirement benefits, the program pays benefits in case of the death or disability of an insured worker. Benefit amounts are weighted in favor of the lower paid and shorter duration employee, thus making possible a meaningful level of benefits for persons currently retired, or disabled, who have not spent many years in covered employment.

Furthermore, as a social insurance program financed through earmarked taxes, OASDI benefits can be adjusted in relation to rising earnings levels and to changing standards of living.

In addition to the OASDI program, there are other public retirement systems which cover such special groups as railroad workers, Federal employees, and State and local government employees. These programs, together with OASDI, are now paying benefits to almost 15 million out of the more than 18 million persons aged 65 and over.

Some of the persons not receiving benefits through the public retirement systems are drawing veterans' pensions and compensation or receiving public assistance payments. And, of course, many of those not now drawing benefits are still working full time and will receive benefits when they retire.

Private retirement plans have grown rapidly since the end of World War II. From 1945 to 1953, the number of workers covered by such plans doubled to a total of 13.2 million. In the following years coverage increased on the average more than 1 million a year.

At the end of 1964, private retirement plans, including deferred profit-sharing plans, were covering an estimated 25 million workers, a notable advance for a voluntary program.

By no means all workers who are covered will actually qualify for pensions. But, for those workers who receive them, private pension plans make possible a more adequate retirement income in relation to past earnings than is available through the basic OASDI system. This is especially the case with respect to regularly employed members of the labor force with average and above-average earnings and for the career employee.

Private pensions of any significant amount go primarily to these groups. The amount of the private pension is typically related to the individual's length of service with the particular firm or industry. The pension is also usually related to the individual's earnings, with greater credit frequently given for earnings above the OASDI wage base than for earnings below this amount.

Despite their rapid growth and progress, however, private plans are still some way from playing a major role in the economic security arrangements of older workers. The numbers covered by private plans represent only about 46 percent of the private wage and salary labor force of 53 million.

By way of contrast, the OASDI system was covering 48 million workers or 90 percent of the private wage and salary labor force at the end of 1964.

Moreover, data on coverage under private pension plans give a somewhat misleading impression of the role that private pensions are playing today—namely, how many persons are currently receiving private pensions.

According to the latest estimates, about 2.4 million persons are in receipt of periodic benefits from private plans, of whom perhaps one-sixth are under age 65—early retirees, the disabled, and widows. Thus, there is only one pensioner aged 65 and over for every 13 workers covered by a private plan.

Under the OASDI system, the ratio is 1 to 7. This gives a somewhat rough indication of the degree to which long-service requirements, employee turnover, and the lack of vesting provisions are cutting down the number who are actually receiving a private pension in old age, even though they have been covered by a private pension plan at some time during their life.

The Social Security Administration's 1963 Survey of the Aged indicates the limited extent to which persons aged 65 and over receive income from private group pensions. Sixteen percent of the married couples and 5 percent of the nonmarried persons were in receipt of private pensions in 1962.

This may be compared with the 79 percent among married couples and the 62 percent among nonmarried persons who were receiving OASDI benefits. In the aggregate, private pensions provided persons 65 and over with only 7 percent of their income from retirement programs in 1962. The OASDI program, in contrast, was responsible for 70 percent.

Most of the persons in receipt of private pensions are also receiving OASDI benefits. They now constitute about 23 percent of retired beneficiaries under OASDI. These persons constitute the economically elite among the retired OASDI beneficiaries.

Their median total income of $3,400 was only one-sixth less than that of beneficiary couples with at least one member working at a full-time job. And for nonmarried beneficiaries a private pension did as much as full-time employment to raise the average level of money income.

For some time to come, the coverage of private retirement plans is expected to continue to grow at a faster pace than the labor force. The President's Committee on Corporate Pensions Funds and Other Private Retirement and Welfare Programs estimates that by 1980 private retirement plans will be covering 42 million workers or almost three-fifths of the private wage and salary labor force.

The number of beneficiaries is expected to rise to 6.6 million; a number, however, still considerably short of the more than 18 million retired workers expected to be on the OASDI rolls by 1980.

The projections cited here, of course, assume continuation of present conditions and trends—favorable tax legislation, a high employment economy, and continued employer-employee interest in retirement programs.

If additional governmental and nongovernmental stimuli are applied to the private pension movement, then the growth of private plans might be accelerated. On the other hand it must be recognized that requirements for funding and vesting, desirable as they may be, could lead to some slowdown in growth.

Even under the most favorable assumptions, it appears clear that for many years to come the majority of employees in private industry will continue to reach retirement age without qualifying for a private pension.

According to the President's Committee estimates, the number of annuitants receiving private pensions, plus their wives, will probably not exceed 30 percent of the total population aged 65 and over in 1980. In contrast, an estimated 85 percent of the aged persons will be receiving OASDI benefits in that year and an additional 8 percent will be eligible for such benefits if they choose to retire.

Some of the limiting factors to private pension plan growth are as follows: Private retirement plans have made the most rapid gains in those industries that lend themselves to coverage most readily. The manufacturing, transportation, public utilities, and mining industries, which account for less than half the employment in private nonfarm establishments, have more than 80 percent of all workers now covered by retirement plans.

Senator RANDOLPH. Dr. Merriam, may I interrupt. When you say mining industries, do you include the mining of coal in a State like West Virginia?

Dr. MERRIAM. Yes, sir. This would include coal mining, tin, gold, all mining.

Senator RANDOLPH. Thank you very much.

Dr. MERRIAM. These industries are characterized by large-scale operations and strong unions. It is estimated that from two-thirds to three-fourths of the workers in these industries are covered by private retirement plans.

This is in sharp contrast with the situation in the wholesale and retail trade and service industries which have many small employers and high rates of employee turnover. Probably less than one-fifth of the workers in these industries are covered. And because of the higher turnover rates, I would assume also that the proportion of covered workers who are covered for present pensions is smaller in these industries.

Any attempt to estimate future growth must take into consideration the fact that the groups left uncovered so far represent in large part those whose characteristics are least amenable to incurring the long-term obligations involved in a private pension plan—such as small, marginal, and seasonal employers.

In the second place, as already mentioned, extending the coverage of private pension plans is only part of the problem. The number of persons who will actually receive a pension will continue to fall considerably short of the number who have at some time been covered, unless coverage is accompanied by some type of vesting provision that would not penalize workers who switch jobs and by other measures that would provide greater assurance that adequate funds would be available to pay the promised benefits if a firm encountered adverse economic conditions, went out of business, relocated, automated, or merged.

But for many employers such provisions would run counter to their objectives in establishing and maintaining a private pension plan. These objectives include a desire to retain valuable and experienced employees, to reduce labor turnover and its attendant costs, and to reward long service.

There is some feeling that many of these objectives can best be achieved when individual employers are given maximum flexibility to adapt their private pension plans according to special circumstances, needs, and financial ability.

To the extent that public policy dictates requirements for vesting or funding of pension plans as a condition for tax subsidy, the flexibility of private plans would be limited. Because of the need to strike a proper balance between flexibility and public interest, any measures for making private pension benefits more widely available must be of a modest nature—they must avoid the imposition of heavy costs or other burdens that would tend to stifle growth or discourage the establishment of new plans.

In short, the inherent characteristics and limitations of private retirement plans must be considered in any realistic appraisal of what can be accomplished through the various proposals that have been made for the Federal Government to encourage the extension of private plan coverage to more of its citizens.

It is my own feeling that we are more likely to overstate than understate what public policy can do in providing a growing proportion of the Nation's workers with supplementary retirement benefits.

It follows from this that since protection under private pension plans will always be far from complete, it cannot be viewed as a substitute for a public program. As already seen, the public programs, primarily OASDI, will continue to provide the only formal retirement protection for the great majority of persons past age 65 at least for many, many years to come.

Since OASDI will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows, and dependents, the main task of public policy in the retirement field, as I see it, is to assure a universal adequate system including an earnings base and a benefit formula under OASDI that keep pace with changes in wages and result in benefit levels that are reasonable in relation to general living standards, without reference to any possible supplementation.

At the same time, an adequate public program would make it more feasible costwise for private pension plans to extend and liberalize their provisions with respect to coverage, and vesting and thus make likely more widespread supplementation.

In making this statement, I do not wish to imply that the Federal Government should have no concern nor interest in developments in the private pension movement. The private pension system has an important role to play in the Nation's total retirement security structure.

For OASDI beneficiaries in receipt of such pensions, the supplementary benefit certainly at the present time means the difference between a less than modest and a reasonably comfortable level of living.

This supplementation that private pensions plans provide to the basic public system is the primary justification for the indirect public subsidy involved in the favored tax treatment given such plans.

As the report of the President's Committee concluded:

In view of this social purpose, 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.

As I have indicated, it seems to us that one of the ways of doing this is to assure a more adequate foundation on which they can build.

Thank you, Mr. Chairman.

Senator RANDOLPH. Thank you, Dr. Merriam.

This statement was prepared by Mr. Robert Ball, is that correct?

Dr. MERRIAM. That is right.

Senator RANDOLPH. Did you participate in its preparation?

Dr. MERRIAM. Yes, sir.

Senator RANDOLPH. I felt that you were knowledgeable on the statement itself.

I wish to ask you to turn to your statement where you say—

Even under the most favorable assumptions, it appears clear that for many years to come the majority of employees in private industry will continue to reach retirement age without qualifying for a private pension.

What should be done in a situation of this kind? Is this a failure of private pensions plans, or is it something that we cannot cope with, or can we do something constructive?

Dr. MERRIAM. I think one has to go back to the basic philosophy as to the purpose of the private pension plan.

Certainly at the outset such plans were intended primarily to reward long-service employees, to hold them with a particular employer. As they have developed, they have become an important mechanism, an institutional arrangement for taking care of the retirement income of the higher paid workers, particularly the executive group. They provide some supplementation to other groups of workers, though primarily it is the average and above average worker who is now covered.

It seems to me that these objectives that I have mentioned are important and valuable ones. We need this kind of an institutional arrangement in addition to the public program.

A question can really be raised, however, as to whether for the great bulk of workers, particularly the self-employed, domestic workers, agricultural workers, those who move frequently, whether the more appropriate method of assuring them an adequate retirement income is not through a public system. Consequently, I think we would feel that it was not necessarily wise to think up ways of trying to extend private plans to everybody.

Senator RANDOLPH. Thank you, Doctor.

Are private pensions a necessary supplement to our OASDI (social security) or could social security do the complete job of providing adequate retirement benefits, if benefit levels were raised?

Dr. MERRIAM. Certainly the benefit levels under social security could, and we would say should, be raised. I think, however, that the complete job of providing adequate retirement income to all parts of the population could not be done through the OASDI system, nor should we attempt to do this.

As I indicated for executives and other higher paid employees, probably we would never want to provide the kind of benefits under a compulsory system that would meet their needs.

Senator RANDOLPH. You feel, then, there is a very natural and needed role for both the private and public pension systems?

Dr. MERRIAM. Yes, sir.

Senator RANDOLPH. They complement or supplement each other?

Dr. MERRIAM. Yes, they complement or supplement one another, and they are both important institutional arrangements we need in our society.

Senator RANDOLPH. And we need to carefully check these as the years go by, because of the transition within our industrial complex and the very nature of our living. Is that not a fact?

Dr. MERRIAM. The changes in our output, the generally rising standards of living, certainly affect what as a matter of public policy we want to do in terms of retirement income for all older people. This should be reflected in the public program.

It always has been to some extent. One of the advantages of the public program is that because of the broad base for contributions and the fact that the income from the payroll tax automatically moves up as wages rise, particularly if the taxable wage limit is also raised—we are able to finance benefits which are related to current levels of living, and not to past levels of living.

This aspect, too, has to be looked at, and also the patterns of employment. If more people are going into service industries in this country, it may well be that OASDI will necessarily play a more important role.

Senator RANDOLPH. Thank you very much, Dr. Merriam.

Senator Morse, would you have any questions or comments?

Senator MORSE. Mr. Chairman, I do not have any questions, for the reason I now give, that in this field I think I am exceedingly illiterate.

Senator RANDOLPH. I contest that statement.

Senator MORSE. I know better than you do on that one, not on most things, but on that one. But I come as a student to a seminar, and I have a suggestion of procedure to make.

My surmise is that when we get through with the statements of the various witnesses whose names I see on this list—and I commend you and Mr. Norman for the compilation of this witness list—I think when we have heard their statements, that we will then be in the best position to ask questions.

I would like to suggest the same procedure that the Senator knows we have followed in the Education Subcommittee, in which he gives me such able assistance, that it be understood by these witnesses that when we have finished the so-called formal statement of the case in chief, that the members of the committee will submit to Mr. Norman questions they wish to have answered as a supplement to the statement.

I think a lot of the questions we could ask now would be answered by the witnesses themselves during the course of the hearing, and we would save a lot of time by listening to them first, although some questions ought to be asked, undoubtedly, as we go along.

But these witnesses ought to understand as conflicts of points of view develop and even holes left in the evidence that we need are found, that we as members of the committee submit the request to Mr. Norman to transmit to the witnesses for supplemental statements, and that Mr. Norman himself in performing his services to us as members of the committee be charged with the responsibility of analyzing this record and before it is closed submit to these witnesses requests for supplemental statements.

I just think we have to have a record here that will answer the questions we will have to consider in executive session.

That is the only suggestion I have by way of procedure.

Senator RANDOLPH. Senator Morse, this is very constructive, and the chairman of the subcommittee is grateful for your suggestion. I do know that it has been a most effective suggestion on the Subcommittee on Education.

It will help us here to proceed in the way you have suggested, although there may be a little flexibility, as you have indicated, of questions that seem pertinent at that time. We should probe more deeply as we study the statements, attempting to find within the depth and scope of what they said the reasoning behind it, and then to ferret out more detailed answers.

I think this is very, very necessary.

Senator Fong, would you desire to question the witness?

Senator FONG. Yes, I would, Mr. Chairman, but following the suggestion made by the distinguished Senator from Oregon, I think that is a very valuable suggestion. Some of the questions I would ask Dr. Merriam will probably be answered by other witnesses that will appear before us.

I think we need not waste the time of the committee members to have these questions asked which might be answered by other witnesses who will appear. I think it will be a good policy to submit the questions later, and address them to those who have testified.

I certainly would like to go into the question of the old-age fund, I would certainly like to go into the question of what percent of a man's salary should be given to the fund to make it so that he may have a sufficient amount to live with at the time of his retirement, and other matters like that.

But I think this matter will be answered by others, so I would say that I subscribe to the formula set forth by the distinguished Senator from Oregon, and I will refrain from asking any questions at this time.

Dr. MERRIAM. Senator, we will be glad to submit for the record answers to those and any other questions that you may have, if they are not answered in the course of the hearings.

Senator RANDOLPH. Thank you very much, Dr. Merriam. You have been very helpful to the subcommittee.

(Subsequently, the subcommittee received the following letter from the Social Security Administration in response to a question.)

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE,
SOCIAL SECURITY ADMINISTRATION,
DIVISION OF RESEARCH AND STATISTICS,
Washington, D.C., April 1, 1965.

Mr. J. WILLIAM NORMAN, Jr.,
Staff Director, Special Committee on Aging,
U.S. Senate, Washington, D.C.

DEAR MR. NORMAN: This is in reply to the following question posed by your committee which you asked us to comment on: "To what extent is the revenue loss (from present favored tax status of private pensions) offset by decreased Federal expenditures such as those for public assistance?"

We do not believe that Federal expenditures for public assistance have been decreased to any appreciable extent by payment of private pensions. Unpublished data from the Social Security Administration's 1963 Survey of the Aged show that the median monthly OASDI benefits for married couples with one or both members entitled to OASDI benefits was $149 for those receiving private pensions and $113 for those not receiving private pensions. A similar disparity shows up with respect to retired nonmarried men—$105 as against $74. Thus, persons with private pensions constitute the economically elite among retired OASDI beneficiaries. They are entitled to OASDI benefits that are appreciably above the average, reflecting in turn above-average earnings which probably in most cases permitted some building up of assets and other sources of income for old age. It would seem unlikely that even if this group were not in receipt of private pensions that the income situation of many would be such as to force them on to the old-age assistance rolls. And it is estimated that about 90 percent of the recipients of private pensions are drawing OASDI benefits.

Sincerely yours,

LENORE EPSTEIN, *Deputy Director.*

At this point I wish to have placed in the record the statement of the distinguished Senator from Georgia, Senator Talmadge. He has introduced Senate bill 177 which will require that professional service corporations and associations be recognized and taxed as corporations by the Internal Revenue Service. He thinks this has a tremendous influence on the extent of private pension plan coverage.

At this point in the record we will include his statement.

(Prepared statement of Senator Talmadge follows:)

STATEMENT OF HON. HERMAN E. TALMADGE, SENATOR FROM THE STATE OF GEORGIA

Senate bill 177, requiring that professional service corporations and associations be recognized and taxed as corporations by the Internal Revenue Service, would have a tremendous effect upon the extent of private pension plan coverage.

The present treatment by the Internal Revenue Service of the professional associations incorporated under State law is discriminatory in that it denies them the standard corporate deduction for contributions to retirement plan funds. My bill seeks to correct this inequity by placing these associations on an equal footing with business corporations for Federal income tax purposes.

Such a stimulus would undoubtedly result in a proliferation of private pension plan coverage. By removing the basis on which the Internal Revenue Service has arbitrarily and capriciously construed the tax status of these entities, the managing partners or central control of professional service organizations would be encouraged in their efforts to provide maximum retirement benefits for their associates. This would not only promote thrift, but would provide security for their members in the afterproductive years. Moreover, judging from the vast number of professionals that would be covered, the benefit to the entire Nation is readily apparent.

Senator RANDOLPH. We have also received another statement in support of Senator Talmadge's bill, S. 177, which will be inserted in the record at this point.

(Statement referred to follows:)

PREPARED STATEMENT OF THOMAS H. CRAWFORD, JR., ATTORNEY AT LAW, JACKSONVILLE, FLA.

Mr. Chairman, and other distinguished Senators of the subcommittee, this statement is submitted in the hope that it may help you to appreciate the need for amending the Internal Revenue Code as proposed by Senator Talmadge's bill, S. 177, and similar proposals.

Testimony presented during these hearings will undoubtedly show that the least progress in extending private pension coverage has been experienced in small business and professional units, and that this is the group which is most in need of Federal action to encourage adoption of pension plans. Enactment of Senator Talmadge's bill would be of tremendous assistance in providing pension coverage for America's professionals and their employees.

Until enactment by Congress of the Self-Employed Individuals Tax Retirement Act of 1962, self-employed taxpayers could not receive any benefit from the Federal income tax provisions which favor pension plans, since private pension coverage could only be given to an "employee" as that term is defined by the Internal Revenue Code. As a practical matter, this phenomenon had the side effect of excluding, not only the professionals but also, a large number of the nonprofessional employees of self-employed professionals from any private pension benefits. Both before and after the passage of the 1962 act, some professionals had sought to avail themselves of the pension benefits of employee status by incorporating their practices and becoming the employees of their own professional service corporations. There has been some questions as to whether some professions could be practiced in corporate or association form in some States under State law. To resolve any doubts, and to conform to then existing Treasury regulations, at least 33 States have enacted statutes permitting professionals to incorporate or form associations and practice their professions in one of these forms. The States with such statutes are:

Alabama	Association.	Nevada	Corporation.
Arizona	Corporation.	New Jersey	Do.
Arkansas	Do.	New Mexico	Do.
Colorado	Do.	North Dakota	Do.
Connecticut	Association.	Ohio	Association.
Florida	Corporation.	Oklahoma	Corporation.
Georgia	Association.	Pennsylvania	Association.
Idaho	Corporation.	Rhode Island	Corporation.
Illinois	Do.	South Carolina	Association.
Indiana	Do.	South Dakota	Corporation.
Kentucky	Do.	Tennessee	Association.
Louisiana	Do.	Texas	Do.
Massachusetts	Do.	Utah	Corporation.
Michigan	Do.	Vermont	Do.
Minnesota	Do.	Virginia	Association.
Missouri	Do.	Wisconsin	Corporation.
Montana	Do.		

The Treasury Department has looked with disfavor upon these efforts by members of the various American professions to obtain for themselves and their employees the retirement security of private pension plans on the same terms as are provided in the Internal Revenue Code for employees of other corporations. In proposed regulations published on December 17, 1963, the Treasury Department advanced a theory that professional service corporations, even though unquestionably valid as corporations under the laws of the jurisdictions in which incorporated, are not "corporations" within the definition of that term in Internal Revenue Code section 7701(a)(3), which reads as follows:

"(3) *Corporations.*—The term 'corporation' includes associations, joint stock companies, and insurance companies."

It is also noted that if the Treasury regulations had been issued in the proposed form, they would also have interpreted the use of the term "corporation" in the definition of "person" to exclude professional service corporations. The definition of "person" is as follows in code section 7701(a)(1):

"(1) *Person.*—The term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation."

At hearings on these proposed regulations early in March 1964 some 90 oral objections were presented by representatives of a wide range of professions. After almost a year of deliberation, the Treasury issued T.D. 6797 which stated its final regulations, and which was printed in the Federal Register for February 3, 1965, on pages 1116 and 1117. In these regulations, the Treasury appears to have only slightly receded from the extreme position taken in its proposed regulations. However, it is clear that under these final regulations, professional service corporations will be forced to run the gantlet of many technicalities to win administrative recognition as corporation for purposes of the Internal Revenue Code, including the benefits of its pension provisions. It is highly doubtful that the courts will uphold the new regulations' exclusion of professional service corporations from the code's definition of corporations. In all probability, the courts will hold that these corporations have been created as separate legal entities by their respective States and that it is unthinkable that Congress had any intention to exclude any such separate legal entities from the code's definition, based upon the esoteric criteria outlined in the new regulations. Nevertheless, it will take time for this issue to be litigated and brought to a binding decision. In the meanwhile, the regulations will discourage organization of professional service corporations and establishment of private pension plans for professionals and their employees. For those whose pension coverage is thus delayed, this can only mean reduced pension income in old age.

Enactment of S. 177 would clarify this issue once and for all, and clarify it in a manner which would encourage extension of private pension coverage, the laudable purpose of this subcommittee in conducting these hearings. This is the action which I urge your subcommittee to recommend.

In conclusion, I should like to dwell upon the injustice of denying professionals the privilege of creating corporations which will be recognized for Federal tax purposes and the denying of the pension privileges incident to corporate status, when businessmen have and always have had that privilege. In the final analysis, the taxpayer, in general, produces income by selling his time and efforts. This is true whether the final products of his time and efforts be tangible or intangible in nature. As far as the individual taxpayer is concerned, there is, or should be, no basic taxable difference between the creation of something tangible like a manufactured product, or the enhancement in value of something tangible by transporting it, or by making the tangible product available to customers by means of a retail sale, or whether the final result of the expenditure of the taxpayer's time and efforts be an intangible one such as the cure of an illness or the protection of a legal right. Since Congress has made available certain private pension privileges and benefits to taxpayers who incorporate, Congress should make certain that all taxpayers are afforded equal opportunities to qualify for these privileges and benefits.

Senator RANDOLPH. Mr. Bernstein, will you please give us your statement at this time?

We will say to the witness we want him to proceed as he thinks will be most helpful to the subcommittee, pointing out certain emphases in his statement, or giving it in full.

The committee wants to accommodate you, sir.

STATEMENT OF MERTON C. BERNSTEIN, ESQ., LECTURER, YALE LAW SCHOOL, AUTHOR OF "THE FUTURE OF PRIVATE PENSIONS"

Mr. BERNSTEIN. Thank you very much, Senator.

I will proceed as you suggest. I would like to have my prepared statement put in the record.

Senator RANDOLPH. That will be considered as read.

(Statement referred to follows:)

PREPARED STATEMENT OF MERTON C. BERNSTEIN

Chairman Randolph and members of the subcommittee, you are to be congratulated for these hearings which should help focus attention upon an urgent but rather neglected problem—the inadequate incomes of the great majority of the elderly. The specific topic of this set of hearings, the possibilities of expanding coverage of private pension plans, especially merits study.

I. WITNESS' BACKGROUND

Therefore it was with pleasure that I accepted your invitation, Mr. Chairman, to appear and testify at the opening session of these hearings. I have been deeply and intimately concerned with retirement and pension problems for a large part of my professional life. In 1959, under a grant from Walter E. Meyer Research Institute of Law, I began a study of the adequacy of private pension plans. Last year that study was published ("The Future of Private Pensions"—Free Press-Macmillan). In the recent past I acted as a consultant on pension problems to the Treasury Department and the Department of Health, Education, and Welfare; and the staff of the Cabinet Committee, were provided at their request, with major sections of my book while it was still in manuscript.

During the last several years I have been teaching, among other things, the course in social legislation at the Yale Law School, a course which deals not only with the public social insurance programs but the related private programs as well.

In the 85th Congress (1957–58) it was my privilege to serve as special counsel to the Subcommittee on Railroad Retirement of the Senate Committee on Labor and Public Welfare. And during the years 1953–56, as legislative assistant to Senator Wayne Morse, I also had frequent occasion to work on legislation and proposals in the retirement and pension field. In the 82d Congress, I was counsel to the Subcommittee on Labor and Labor-Management Relations which was so vigorously chaired by the then Senator Humphrey.

II. THE ELDERLY'S NEED FOR ADDITIONAL CASH INCOME

Today the elderly of America are in economic exile. That also means that they frequently live in social exile as well. When earnings from work stop they enter into a financial decline which gets worse and worse as they get older and older. And to complicate matters, with advancing age they progressively use up what financial and material resources they have. Life gets more and more threadbare as the ability to substitute effort for cash ebbs.

While some improvement in the overall picture is probable, chiefly due to harvesting the improvements made in the social security system during the 1950's there are offsetting factors—principally the unemployment difficulties of people in their 50's and 60's—which will slow the rate of progress. If earlier retirement spreads, these difficulties will intensify because earlier retirement reduces both social security benefits and private pension benefits.[1]

(a) Cash income inadequacy

The 1963 Survey of the Aged by the Social Security Administration reveals the financial fix in which millions of elderly Americans find themselves. I limit this presentation to a few items of special significance.

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[1] Demonstration of this may be found in my article in the forthcoming May 1965 issue of Industrial Relations.

TABLE I.—*Money income of social security beneficiaries aged 65 to 72 in 1962 (by percentage)*

	Married couples (percent)	Nonmarried men (percent)	Nonmarried women	
			Retired (percent)	Widowed (percent)
Income:				
Less than $1,000	4	19	29	34
$1,000 to $1,999	20	45	42	51
$2,000 to $2,999	30	27	19	10
$3,000 to $3,999	18	6	3	2
$4,000 to $4,999	12	2	2	(*)
$5,000 to $9,999	15	2	1	1
$10,000 and over	3	(*)	(*)	(*)

*Less than 0.5 percent.

Source: "Income of the Aged in 1962: 1st Findings of the 1963 Survey of the Aged" 27 Social Security Bull. (No. 3) 3, 17 (adapted from table 10) (1964).

As table I shows, more than half the married couples aged 65 to 72 in receipt of social security benefits have money income of less than $3,000, which is roughly the benchmark of poverty and in 1959 was the approximate amount required by a budget of decency for a couple.[2] Almost two-thirds of the nonmarried men fall below the income required for a barely decent standard of living. Worse off are women—especially widows; even with OASDI benefits, 85 percent of the widows aged 65–72 have cash income below $2,000.

The figures are even more disheartening for those over 72 and those without OASDI benefits. Where income exceeds the BLS budget figures it usually is attributable to earnings from current employment.

Quite clearly, the mere spread of social security eligibility (which happily should improve, but will not become universal) will not bring the elderly into hailing distance of a decent standard of living.

(b) *The inadequacy of individual savings*

It is a fact of life that individual savings of the elderly have little or no income-producing value.[3] Excluding equities in homes, the median value of assets owned by people 65 and over was $2,950.

This does not mean that people do not save and try to save. Many own their own homes—representing a lifetime of saving. Cars, clothing, furniture, and appliances may be regarded as a form of saving. But they have little or no income value. Some of the elderly, those who enjoyed above-average or extremely good incomes, do have income-producing assets, but most have none or negligible assets of this kind.

Moreover, a great deal of individual saving is badly done. So, for example, some 500,000 people still have postal savings accounts which yield only 2-percent interest—the same rate as when the System was established in 1911. Almost $50 billion are tied up in U.S. savings bonds; acquisitions run at about $4 billion a year. If held to maturity these bonds now pay 3½ percent annual interest and even less if cashed in before maturity, as so many are. In comparison, savings banks now pay 4 or 4¼ percent and savings and loan associations offer as much as 4.8 and 4.9 percent—in insured accounts.

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[2] Margaret Stotz, "The BLS Interim Budget for a Retirement Couple," 83 Monthly Labor Review (No. 11) 1141 (1960). One need only scan the budget to see how minimal it is: e.g., it allows for 9 eggs a week for 2 people and the replacement in a year of two-thirds of a pair of women's nylon hose, one-fifth of a blanket, and an annual television repair charge of $1.22. (That figure—$3,000—has since been lowered, by the Bureau of Labor Statistics, to $2,500 so as to reflect advantages of home owning; the original budget was based upon rented quarters. The Social Security Administration contends that $2,800 more realistically reflects transportation and health costs. As the Survey of the Aged breaks its categories at $2,999, I use $3,000, especially as the 1959 budget is really bare-bones and there was some inflation between 1959 and 1962.)

[3] The President's Committee on Corporate Pension Fund's Report, Public Policy and Private Pension Programs (1965) declares: "The benefits payable under this basic system [social security] are supplemented in several ways. Traditionally, a large proportion of older people have individual savings which provide an additional resource during their retirement," p. I. This just is not so.

If elderly Americans—and those who enter their ranks in the decades ahead—are not to suffer serious financial demotion despite a lifetime of self-support, we need the determination, foresight, and prudence to provide more adequate retirement income and we have to devise ways of providing it.

III. THE LIMITATIONS OF SOCIAL SECURITY

As social security is presently constructed it will not achieve its assigned role of enabling the retired to live at a standard of decency and self-reliance. The enactment of a program of hospital care insurance will ease the plight of many. But the elderly will not live by medical care alone. Happily only a small fraction are institutionalized at any one time. Most live together as couples and alone. They need cash income.

At the present time, cash benefits of OASDI fall below the subsistence level; in most cases, way below.

TABLE II

Benefit amounts payable to a retired worker who comes on the benefit rolls at age 65 or over under present law and under the Council's recommendations

Average monthly earnings	Monthly primary insurance amounts		Percent replacement of average monthly earnings	
	Present law	Proposal	Present law	Proposal
$67 [1]	$40	$43	59.7	64.2
$100	59	63	59.0	63.0
$110 [2]	65	70	59.1	63.6
$124 [3]	68	73	54.8	58.9
$155 [4]	74	91	47.7	58.7
$200	84	101	42.0	50.5
$300	105	122	35.0	40.7
$400 [5]	[5] 127	144	31.8	36.0
$500	[5] 127	165	25.4	33.0
$600 [6]	[5] 127	[6] 186	21.2	31.0

Benefits payable to a married couple coming on the benefit rolls at age 65 or over under present law and under the Council's recommendations

Average monthly earnings	Monthly benefit amount		Percent replacement of average monthly earnings	
	Present law	Proposal	Present law	Proposal
$67 [1]	$60.00	$64.50	89.6	96.3
$100	88.50	94.50	88.5	94.5
$110 [2]	97.50	105.00	88.6	95.5
$124 [3]	102.00	109.50	82.3	88.3
$155 [4]	111.00	136.50	71.6	88.1
$200	126.00	151.50	63.0	75.8
$300	157.50	183.00	52.5	61.0
$400 [5]	[5] 190.50	216.00	47.6	54.0
$500	[5] 190.50	247.50	38.1	49.5
$600 [6]	[5] 190.50	[6] 279.00	31.8	46.5

[1] The highest amount of average monthly earnings on which the minimum benefit of $40 is payable under present law.
[2] The highest amount of average monthly earnings to which the higher percentage in the benefit formula in present law is applied.
[3] The smallest amount of average monthly earnings to which the recommended formula applies; at all lower average monthly earnings levels the 7-percent increase is larger.
[4] The highest amount of average monthly earnings to which the higher percentage in the formula would be applied under the Council's recommendation.
[5] The maximum under present law.
[6] The maximum under the $7,200 contribution and benefit base which the Council recommends go into effect in 1968.

Source: 1965 Report of the Advisory Council on Social Security, p. 61.

Table II is from the 1965 Report of the Advisory Council on Social Security. It shows at a glance that social security benefits fall below the subsistence level for most retirees and retired couples and that for those who had high average earnings they replace a small percentage of preretirement income. And the comparison is limited to the portion of the retiree's income credited for social security purposes (now $4,800). If his entire income were included, even smaller percentages would be shown to be replaced. In addition, millions of families enjoy a reasonably comfortable standard of living because both husband and wife work. Usually the OASDI benefit earned by the wife is smaller than what she gets based on her husband's earnings—hence the couple's OASDI benefit represents an even smaller portion of their former earnings than table II shows.

Even if the 15 percent increase in total benefits proposed by the Advisory Council were enacted—and the pending H.R. 1 and S. 1 provide for a 7-percent increase in cash benefits—it can be readily seen that, although the situation would be improved markedly, the pattern already described would persist.

Perhaps even more importantly, the OASDI system with addition of hospital care and its extension to those 62 and over and the totally disabled (rather than being limited to those 65 and over) and a 14-percent cash benefit increase would "run out of gas." I emphatically agree with Senator Ribicoff that a combined employee-employer payroll tax of about 10 percent represents the maximum that can be imposed upon low-pay workers. As the payroll tax is uniform, that represents the practical maximum. Even if all payroll were subject to that rate (instead of the $5,600 in H.R. 1 and S. 1), there would be no money to pay for any improvement beyond the 14 percent over current rates. As a result, as wage and salary rates increase, as they probably will, benefits will lag behind.

Supplementary retirement income is needed if American retirees at practically all earnings levels are to be brought in out of the cold. Private pension plans can help do the job. But they can do the job only if new institutions are created for the purpose and only if the plans themselves are substantially changed and improved.

IV. THE PRINCIPAL GAP IN PRIVATE PENSION COVERAGE—SMALL GROUPS

Since 1940, and especially since 1950, the growth in private pension plan coverage has been nothing less than phenomenal. It is estimated—and the data available could be better—that 24 to 25 million employees are covered by pension plans including deferred profit-sharing plans. The President's Committee on Corporate Pension Plans estimated that about half the people (49 million) employed in private nonfarm jobs are under plans. Coverage is far from uniform. About 60 percent of the people participating in plans work in manufacturing industry. The other sectors of substantial coverage are in transportation (trucking and local transit), construction, public utilities, mining and finance. All together these account for more than 80 percent of the people under plans. Moreover, a few hundred plans account for the great bulk of the employees covered. These are the plans of the corporate giants and multiemployer plans.

Coverage is especially sparse in the trade and service industries. Small companies—even in manufacturing—are difficult to cover. Yet it is in industry where small companies predominate—trade and especially service—that employment growth is expected while in the areas in which plans now are concentrated we are experiencing contracting employment (as in all branches of mining) or growth will be slight or nonexistent. For example, manufacturing employment, despite some slight increases over the last year, is just about where it was more than a decade ago after the end of the Korean war.

As I point out in a portion of my book:

"It often comes as a surprise that there are over 3 million enterprises in the United States, most of them quite small. Only 6.4 percent of the employers filing social security tax returns employ 500 or more employees; some 39 percent of the companies employ 100 or more. There are 84,000 employers with employees numbering 100 or more and 227,000 employers with 20 or more employees. Some 32,610 plan reports were filed under the Welfare and Pension Plan Disclosure Act, which required such reports for plans covering groups of 25 or more employees (some employers make multiple filings).

"Clearly an enormous number of employers have no plan at all. And it seems reasonably clear that the bulk of coverage is accounted for by large employers, especially when only single-employer plans are considered. Even in the steel industry many small companies are without plans. The Steelworkers Union in 1960 bargained for some 995,060 employees in 2,204 separate units. Almost 90 percent of the members had pension plan coverage; but 11.7 percent of the members in 56.9 percent of the units did not. The gaps in coverage occur among the small units. The drop in pension coverage sets in at groups of 1,999 employees or fewer;only three-fourths of the members employed in groups of 309 to 499 are covered, while less than half of the members in groups smaller than 299 are covered. Life insurance coverage is far more extensive in the small groups.

"The sparse private plan coverage in wholesale, retail, and service trades has been ascribed to the smallness of the units involved. It also appears to be true that even in manufacturing industry and highly unionized industries in which plans are common, pension plan coverage is spotty in small employment units. The reasons are not difficult to find: higher costs, lower earnings, and greater enterprise mortality than among larger business enterprises.

"Clearly, economies associated with size are to be had with pension plans. Conversely, plans for small groups may have proportionally high costs. The basic and irreducible minimum actuarial, administrative, and legal costs of constructing and operating a plan are higher per capita and as a percentage of contributions in small plans than in large ones. Insurance companies reserve the right to terminate group plans when their membership drops below a certain number (often 50 'lives') or some percentage of eligibles (frequently 75 percent) because in small groups the 'averages'—based on very large populations—on which actuaries rely are of little or no use. Commissions (acquisition costs) for plans with insurance carriers can be substantial. They represent a particularly large percentage of the first several thousands of dollars of annual premium; so that a small plan carries a higher per capita burden for this kind of expense than larger plans.

"The net earnings on contributions for small plans tends to be lower than for large plans. Many small plans use individual annuity policies. For the most part such plans are 'non-participating,' i.e., premiums are fixed without provision for 'dividends' that might result from favorable investment or risk experience. Hence, the costs of these arrangements are higher than alternative insurance company administered plans. Small trusteed plans require substantial amounts of retained cash to meet current expenses and benefits; only the remainder can be invested.

"Generally, small groups mean small funds. With a small fund the investor has the problem of emphasizing either safety or yield to the detriment of the other. The diversification possible with large funds more readily promote both safety and yield. What evidence there is indicates that small funds have a lower rate of return than more ample funds. This may be overcome by pooling funds. a service offered by some banks. But little is known about the prevalence of pools and their comparative yield.

"The technical nature of various kinds of plans and the intense competition among those who offer them, which in some cases does not stop short of misleading potential clients, makes it difficult for an employer to make an informed choice. The consulting actuaries to whom he turns may be associated with one of the competitors. The choice may be fairly costly with a high possibility of error. In 1960 the International Association of Machinists established a multiemployer fund with employers 'that could not ordinarily provide pensions on their own.' By mid-1962 the pooling arrangement included employees in 124 companies in 24 States. A UAW staff member informed me that his union assists small employers in setting up pools administered by bank trustees. I judge that while this helps to meet the problem, neither pool arrangements nor employees covered are numerous. The pooled fund ameliorates but does not overcome the difficulties of establishing and operating plans for small groups.

"The high mortality rate of small companies is notorious. They die easily and early. Employment in such companies promises little in the way of retirement benefits even if there is a retirement plan in effect during all or part of the firm's existence. Moreover, vesting is particularly troublesome under small plans with brief existence because it is costly to vest small benefits. Furthermore, corporate trustees are loath to continue a trust where the employer has ceased contributions. So, whatever rights employees have generally are 'commuted' into a cash payment or translated into a paid-up fixed benefit annuity, often for small amounts.

"In summary, small groups of employees make it difficult for employers to provide pension plan coverage, and such coverage is less dependable for employees than that provided by large plans."

Hence the major problem to be solved, if pension plan coverage is to be substantially expanded, is how to bring pension coverage within the reach of small groups and to overcome the evaporation of pension plan credits—and the consequent extinction of retirement income—that so often results from small company failure.

Moreover, some insurance and bank officials have told me that they do not seek or welcome small plans. Even with higher proportional fees, they cost more to install and administer than they are worth, especially because they lapse so often so early in life, another item of cost. However, other such officials welcome such business—as my proposal in this area is for voluntary action, it would constitute no imposition upon sellers and purchasers who find present arrangements adequate. There seems a real need for a new means of providing low cost, reliable pension coverage for employees of small companies.

V. THE PROPOSAL—A NATIONAL SMALL GROUP PLAN

What I suggest is a national small group plan in which employees of small companies would enroll directly with their employers making contributions directly into the national plan rather than to an individual insurance company or bank trustee. Although individual employee accounts would be kept showing the contributions made for each, the costs of remitting and recordkeeping would be slight. Indeed, if the reporting, collecting and recordkeeping were accomplished through the social security machinery, which could easily be done, these costs, would be infinitesimal. When an employee left the job or the company expired, he could continue to add credits to his own contributions if his next job had no plan. And when he eventually moved into a job which provided pension coverage through the national plan that employer need only submit the plan contribution along with his social security report and payroll tax remittance to have it automatically credited to the employee's account. In this way employees would not lose track of small amounts of pension savings nor as more often happens, draw it down in cash when a plan folds because it is not now financially feasible to maintain records or pay benefits on small amounts in individual plans. As with individual plans, the plan could credit the employee for past service (years of employment before the plan started) and contributions could be made to pay for such credits within existing limits on deductibility.

The employer would be spared the considerable expense of attorney's fees, consulting fees, commissions and other installation charges, and minimum service charges. Moreover, he would save the time of exploring among confusing, hard-to-assess alternatives if there were one dependable national plan in which he could have confidence.

Of crucial importance in any pension plan is the profitable investment of funds. Earnings on investments and their reinvestment should pay a large part of the benefits of a plan. Hence advantageous investment is a necessity.

This is a key element in deciding whether such a national plan should be wholly governmental, wholly private or a mixture of the two—for it can be any of them.

A wholly governmental pension authority might be limited to investing in Government obligations, which would introduce considerable inflexibility into investment operations and often would reduce earnings and so reduce the benefits payable. While it is not impossible to empower a Federal agency to invest in private companies (for example, some Federal corporations and many State and local government pension funds do), many people would object to such investments by the Federal Government. Some would fear that political or at least nonpension purposes might be served.

It would seem desirable to me to enlist the expertise of the private financial institutions already operating in this field, that is, the insurance companies and bank trustees and, possibly, consultants as well. Unions also would have an interest in such an undertaking and could bring considerable valuable experience and expertise to it. Not only do these groups have the skill and manpower, but giving them a profitable role in such an undertaking could induce their cooperation while a wholly Federal undertaking would surely meet hostile resistance by insurers and banks.

I give a detailed description of the way in which such an institution could be organized in a major portion of my book (ch. X) devoted to discussion of the ways in which a national pension clearing house could be organized. For the national small group plan could constitute but one important function of a clearinghouse. If several functions were performed administrative costs could be further reduced.

Some have expressed to me the fear that while there are economies of scale in a national plan, there also are elements of inflexibility introduced into its investment policies. There is the possibility that a very large fund would hold enormous blocks of stock. Should it become desirable to sell shares of a particular corporation, the availability of such a massive amount of stock could demoralize the market for that corporation's shares and might damage the company itself—hence the fund administrators would feel "locked into" questionable or poor investments. The fund could set up small subfund groups, some on a regional basis, not only to avoid this problem but also to enhance familiarity and expertise in local investments—in real estate, housing, and local governmental undertakings. In other words, the problem seems manageable.

If private plans are to provide retirement income supplements to more employees and a larger proportion of workers, we need some such innovation to bring plan coverage within the reach of employees of small companies. The Machinists Union has a small company plan. But it has the necessary limitations of any one-industry or one-skill multiemployer plan—limited reach, among others. The Industrial Union Department of the AFL–CIO has been exploring an IUD-wide plan for this purpose and perhaps these hearings will cover these efforts, which reportedly have run into difficulty. It is just possible that my more ambitious proposal would be easier to achieve.

VI. CABINET COMMITTEE REPORT GROWTH ESTIMATES QUESTIONED

I believe the problem of extending coverage is possibly more urgent than the report of the Cabinet Committee on Corporate Pensions makes it appear.

Despite recognition of the problems I have outlined, the report projects pension plan coverage increases from an estimated 23.5 million (not quite 50 percent of the employees in private nonfarm establishments) in 1963 to 42.3 million covered (some 63.5 percent of such employees) in 1980. Of course, I appreciate how difficult such estimates are. But I urge inquiry into them and careful assessment because how poor or good coverage prospects are will affect the sense of urgency to seek improvements felt by Congress, the executive branch, employees, unions, the industry, and the public at large.

The basis of the estimates have not been published. But they seem seriously overoptimistic to me. For not only does the estimate call for 42.3 million employees with plans, but an increase in beneficiaries (retirees) from 2.4 million in 1963 to 6.6 million in 1980. Of course, most of that latter increase will come from retirements of people now employed and under plans. To account for these additional 19 million plan participants and 4 million retirees, plan coverage will have had to add some 23 million or about double present coverage by 1980. The average annual net increase of plan coverage would therefore have to be about 1.4 million. Indeed the projections call for larger increases in the next few years and a slower rate of growth later.

But actual recent rates of growth seem to have been much slower. So, for example the rate of growth in 1964 was between an annual rate of 500,000[4] and 750,000 newly covered persons in newly promulgated plans. (No figures for employees involved were reported for the several hundred plans terminated; some of whom surely were in the "new" plans. Many of these new plans, most of them small, will collapse in the not-too-distant future.) Given the employment problems of the recent past it seems dubious that already established plans experienced much, if any, expansion in coverage, considering the unemployment distress in many plan-covered companies. And within many companies death and employee separations without replacement account for shrinking coverage under some plans. In addition, there were, and will be, many retirements by people who will die before 1980. All in all, I seriously question the projection and suggest that it be subjected to careful study because it may require scaling down.

[4] The Treasury reports that during the first 9 months of 1964 some 5,115 new pension plans were "qualified;" they "covered" 324,629 employees. Another 3,837 profit-sharing plans with 115,903 employees were qualified. Apparently this latter type of plan is not included in the Cabinet Committee report estimates.

VII. A RELATED PROBLEM—PLAN RELIABILITY AND THE EFFECTIVENESS OF COVERAGE

Whatever expansion is achieved it will be useless unless the plan participants actually achieve benefit eligibility; or else they will have nothing to show for having been under a plan. And if many years of effective credits that pay off in benefits are not achieved, the retirement income they produce will be slight.

As plans now are constituted only a minority—very likely a small minority—will achieve benefits and for many the benefits will be small. This is so because plans require retirement after long service with one employer or provide "vested" credits only to those separated after 10 or 15 years of service and usually only if they also are aged 40 or 45 or even 50 and 55. Due to the main forces in the economy which cause employees to leave jobs and cause jobs to leave employees probably a large majority of those under plans will not achieve benefits.

This major deficiency of plans must be overcome if they are not to fail in achieving their purpose.

To this end I would urge these major steps:

(1) Rapid progress toward early vesting under a set of private pension "guideposts." The recommendations of the Cabinet Committee for vesting are minimal. While I do not believe vesting should be mandatory, I do believe that more liberal vesting than was recommended in the Cabinet Committee report is needed. To this end, I urge this committee and the Cabinet Committee to establish pension standards which are regarded as desirable to the fulfillment of plan purposes. These guideposts—which would cover vesting, funding, self-dealing and other critical problems of plan liability—could be phased, so that a timetable for progressive improvement is outlined. I suggest that they would be influential in bargaining and—because of competitive factors— in unilateral plans as well.

(2) The establishment of a national pension clearinghouse (preferably on a joint Federal Government-private consortium basis) to facilitate the transfer of small vested credits and to administer a national small group pension plan.

(3) Legislation to make employee contributions to plans tax deductible on condition that they cannot be cashed out. Such contributions are favored by many employers. They operate as a species of vesting. Typically contributory plans have more features protecting employee interests and pay larger benefits as well. The adverse effect upon Federal tax revenue would be rather small. A fairly high estimate would be on the order of $140 million using Social Security Bulletin estimates of employee contributions of $780 million (1961); using 1962 SEC estimates the revenue loss would be about $79 million. The steady trend to solely employer contributions and away from employee contributions also results in a revenue loss, but without achieving the protections usually found in contributory plans. In contributory plans the employer typically contributes a great deal more than the employee. Hence even if contributory plans were widely adopted under the inducement of this proposal and a large part of employee contributions were net additions, the revenue loss would be 1 year's tax—roughly 18 percent—of the additional annual contributions.

(4) Make more adequate funding a condition of favorable tax treatment. At the minimum, current costs should be funded on a level basis and past service credits should be funded over a maximum period—probably a shorter period than the 30 years recommended by the Cabinet Committee.

(5) Private plan supplements are needed most urgently by widows who typically receive no pension benefit and but a paltry social security benefit. All segments of industry should make such benefits a high priority improvement.

VII. COSTS OF AN EXPANDED PROGRAM

Given the present tax laws an expanded pension program would result in an apparent Federal tax revenue loss. It should be understood that there is little or no revenue loss due to the deductibility of employer contributions to corporate plans because in most, I would say practically all, cases the contribution would be paid out in some other form of deductible compensation. If it were paid out in cash wages some of it—but by no means all—would be taxed as income to employees, generally at the rate of about 18 percent.

The major tax advantage to employers under present tax laws is that the earnings on pension plan trust funds and insurance reserves are tax free and can be reinvested in full and yield additional tax-free earnings. As a result, to make comparable earnings which are subject to tax in its own business the rate of earnings would have to be double those of the pension fund. Ordinarily earnings of trust funds and other savings are taxed as earned—these constitute the revenue loss.

However, to the extent that these savings make possible net additions to productive facilities, the tax loss is offset by the individual and corporate earnings subject to tax which result from their construction and operation. So far as I know, no one has devised a way of ascertaining whether and to what extent this offset takes place.

And to some indeterminable extent, the tax loss is offset to the extent that future public funds need not be expended as public assistance, to say nothing of the saving in human dignity by enabling people to live on their own savings rather than public handouts granted, often, under humiliating conditions.

Summary

The majority of the elderly are in need. They and those who enter their ranks in the years ahead will continue to be unless we take action at the earliest possible moment to improve the benefits of public retirement plans and to expand the coverage and improve the effective coverage of private plans. Private retirement programs can play an important role in meeting the financial needs of the mass of the elderly. They presently are not designed to play such a role—they are restricted to an industrial elite. Indeed, they seem inadequate to the expectations now pinned to them.

Important segments of the pension industry are prepared for change. But necessary changes will come only if they are vigorously sought.

Senator MORSE. Mr. Chairman, I think for the benefit of other people here we ought to qualify this witness. We did not have to qualify Dr. Merriam because her work on social security is well known, but I think those in the room ought to know that Mr. Bernstein is the author of a book, "The Future of Private Pensions," which has aroused a great deal of discussion in this country.

We feel that he is outstanding in the field of those interested in the problems of the aged. Of course, this morning he comes before us with long experience on the Hill as one of our experts in the legislative process, although he is now a lecturer at Yale.

I want to say that his work, as you well know, as one of our counsel on the Senate Committee on Labor and Public Welfare for several years, was notable. We are all indebted to him.

Of course, many of the good things I may have done in my office in the legislative field are due to him, because he was my legislative assistant for many years.

Do not blame him for my mistakes, but give him credit for some of the good things that I may have done.

I want to welcome Mr. Bernstein and publicly congratulate him on his book. I have heard it discussed pro and con, and the pros far outweigh the cons.

The comments made about this book particularly qualify this gentleman, Mr. Chairman, to give us the benefit of his intensive research on this subject.

I recommend him very highly—this is a commercial, I guess—and also recommend to those in this field that they analyze Mr. Bernstein's book, because I think it is an excellent one.

Mr. BERNSTEIN. Thank you very much, Senator. I cannot go any place but down, after that.

Senator RANDOLPH. You could tell us the price of the book.

Mr. BERNSTEIN. I will just tell you the publisher.

Senator RANDOLPH. Is that MacMillan?

Mr. BERNSTEIN. Yes, it is.

Senator RANDOLPH. Thank you, sir.

Mr. BERNSTEIN. I would like to say any expertise I have is based on my privileged service in the U.S. Senate, as counsel to Senator Morse's Committee on Railroad Retirement and as his legislative assistant, and also earlier as counsel to Senator Humphrey's Subcommitmittee on Labor and Labor-Management Relations.

I would like in my oral presentation to hit some of the highlights of my prepared statement which I think are salient.

First, I would like to congratulate the committee for scheduling these hearings, because they focus on two urgent questions. One is the income problems of the aged, and the second is the specific subject matter of these 2 days of hearings, the problem of expanding coverage, the possibilities of expanding coverage of private pension plans to those not covered.

Let me at the outset sketch in my own background. Under a grant from the Walter E. Meyer Research Institute of Law, I started a study in 1959 of the adequacies of private pension plans, and it was published last year under the title "The Future of Private Pensions."

I also have during the last several years been a consultant on pension problems to the Treasury Department, the Department of Health, Education, and Welfare, and the 20th Century Fund.

In order to discuss the role that private pension plans do play and can play, one ought to assess the needs of the aged. Today the elderly of America live in economic exile. That also means that they frequently live in social exile, as well.

It is a fact of life that in America today when a person reaches retirement age at 65, sometimes it is earlier, he suffers a degree of economic demotion that we do not visit upon any other members of our society.

I suggest that this is an urgent problem, a problem that is being given insufficient attention.

For 3 days this week in Washington, the National Council on the Aging has been holding sessions which fully document the pitiable condition in which the overwhelming majority of the aged live today, and yet it comes through to the public as only a muffled cry—if at all. I am in hopes that this hearing and others like it will help focus attention on this urgent problem.

I would call your attention to some key data, hardly exhaustive examples. In table I contained in my statement I have set forth from the Social Security Administration study of the income of the aged in 1962 the condition of the aged who are second best off. The best off are those with jobs. (See p. 15.)

The second best off are those who are social security beneficiaries. A glance at table I will show that an overwhelming majority of the married couples have total money income of less than $3,000 a year.

The figure of $3,000 is used because in 1959 it was roughly the figure at which the BLS—the Bureau of Labor Statistics—estimated was a budget of adequacy and decency.

How adequate and how decent it is, you can see by looking at some of the items allowed for: For example, an annual TV repair charge of $1.22. Some may call this budget adequate. I think if it is adequate, it is barely adequate.

Nonmarried men living alone have an income, 64 percent of them have cash income below $2,000 a year, which is roughly the budget figure for a standard of decency and adequacy, according to the BLS standards.

Six years later, those prices would undoubtedly be higher, the budget would call for a higher income.

Worse off of all are widows, 85 percent of whom have an income of under $2,000 a year.

I would point out that these figures are only for those between 65 and 72 who do receive social security benefits. If you take those who are older, or those in the same age category who do not have OASDI benefits, or those in retirement below the age of 65, the picture would be worse.

Senator RANDOLPH. Mr. Bernstein, it is not directly on the subject, of course, but with Senator Morse present I think as we talk about a $2,000 annual income for a group of the elderly citizens of our country, it is not inappropriate to say that Senator Morse and others of the Subcommittee on Education are so very concerned with that family earning less than $2,000 a year, in which there are 5 million children ages 5 to 17, of a total of 48 million children in that age bracket in the United States.

I just bring this to the attention of the subcommittee, and our guests this morning, to indicate among the young and among the old there are these problems, are there not, Mr. Bernstein? They are of immediate concern.

Mr. BERNSTEIN. That is correct, Senator. I would say they are of urgent concern.

I would point out, too, that individual savings are both inadequate and usually quite ineffective. The data on this, very briefly, are that the median value of assets owned by people 65 and over in 1962 was just a shade under $3,000, excluding homes. If homes are included, the figure would be slightly in excess of $11,000.

Demonstrably, assets of that sort have little or no income-generating value. At the best they would provide for an infrequent rainy day, and not many of them.

In addition, most individuals do not have the training, the information, or the time to invest with anything like the efficiency and expertise which is available to them under group savings plans, of which pension plans are one primary example.

In a pension plan, ideally, at least, investment policy is in the hands of experts, and very few of us are experts in this area, least of all individuals.

For example, to this day there are about half a million people who have their savings tied up in postal savings, which pay interest rates of 2 percent, precisely the interest rates with which the system was started in 1911, when merely in savings and loan associations they could have earnings 2½ times as much.

I suggest also that from the point of view of the investor U.S. savings bonds represent something less than maximum income, and we have something on the order of $48 billion in such bonds, with acquisitions running at the rate of about $4 billion a year.

I would agree with Mrs. Merriam that the basic defense against need in old age is the social security system, but I suggest also that we must be quite realistic as to what the limitations of that system may be.

There are no certainties in these matters, but as things now stand, one cannot claim that the social security comes close to providing a subsistence standard of living to those in receipt of benefits.

I call your attention to table II on page 16, which summarizes data which is quite well known to you, which demonstrates the inadequacy of current benefits.

For example, widow benefits now average $67 a month, hardly enough to sustain life. That is just not a subsistence income.

We have to look, then, at what the potentialities of the social security system are as it is presently constructed, and changes that might be made, before we can seriously and intelligently consider the role to be played by private plans.

With the enactment of the medicare bill—and those of us outside of Congress consider it as good as enacted, although you still have a great deal of work to do—with its enactment and with the increases provided for in H.R. 1 and S. 1 in both payroll and taxable payroll, there is also provided a benefit increase of 7 percent.

Now I ask you to consult table II, which shows what the effect would be of a 15-percent increase in cash benefits, which is what was recommended in the recently issued 1965 Report of the Advisory Council on Social Security.

If you will look at the bottom table, you will see that for those with average monthly earnings income of $400 or less, under the proposal, the $3,000 annual figure is not reached. For those who have creditable income, average monthly income of $500 to $600, the $3,000 per year amount for a couple would be reached, but then one must look and see how much of the preretirement income of the insured individual is replaced. There you will see in the last column that less than half would be.

Now, whatever the advantages of being old may be, financially, it staggers the imagination that when one passes 65, or 62, he needs only half of his former income.

I would point out further that this data only shows the percentage of income replaced for that amount which is taxable under social security. The percentage figures would be lower if one took into account the total income of the individual.

Further, perhaps more importantly, it is perhaps not fully understood and appreciated how much of the American standard of living is achieved by having multiple workers in a family, principally having a husband and a working wife. Normally, because of the way social security is constructed, the working wife's wages do not result in a separate additional social security benefit, so if one were to include in this data, which the Advisory Council did not do, a comparison of the family preretirement income and the family postretirement OASDI benefits, the contrast would be even more stark than it is.

Now, the 15-percent figure happens to represent what is about the maximum that could be enacted without raising the payroll tax significantly above 10 percent, the point to which Senator Fong was referring earlier.

I agree emphatically with Senator Ribicoff, that 10 percent, something in that area, is the practical limit for a payroll tax, the combined 10-percent rate, because it is a uniform tax and it seems improper, indeed unconscionable, to impose a higher rate of tax upon those in lower income brackets.

Now, even if, and this is a very big if, all limits were removed on taxable income—today, as you know, it is only $4,800. How H.R. 1 before the House Ways and Means Committee will deal with it, I do not know, but the bill as introduced provides for an increase to $5,600. But even if it were raised so there were no limit—the situation would be improved, but the pattern already described would persist because benefits could not be raised more than 15 percent.

There has been discussion about financing the social security system in part from general revenues. Unless that path were taken, the limits upon the social security system, as it is presently constructed, are obvious, and it would yield insufficient retirement income.

This means that some source of income supplementation is urgently required, and inasmuch as private pension plans require a very long period in which to mature, the sooner we set about seriously considering expanding coverage and set about the job of actually expanding coverage, the better.

Unless dramatic and substantial and basic changes are made in the social security system, it would seem that private pension plans are the principal source to which we will have to turn in order to achieve decent standards of living in retirement.

The growth of plans has been phenomenal since the beginning of the 1940's, and particularly during the 1950's.

Mrs. Merriam pointed out coverage is concentrated in a few areas, particularly in manufacturing, finance, transportation, which is mostly because of the Teamster plans and local transportation system plans, and public utilities.

Coverage is sparse in the areas in which employment is growing, in trade and service industries. Coverage is sparse even in manufacturing among small employers. For example, even in the steel industry the Steelworkers Union has had extreme difficulty in extending pension plan coverage to small groups, and small groups for that purpose means several hundred employees.

The reasons for the difficulty of achieving small group coverage are fairly clear. One is that it is disproportionately expensive to do so. The costs of consultants, of lawyers, of actuaries, of accountants in setting up plans, the acquisition costs of those who sell and install plans, and the basic charges for administering plans are disproportionately high for small groups of employees, to say nothing of the fact that most small employers do not have the time or the information to choose intelligently from among the myriad of plans that are available to them.

Senator RANDOLPH. They are sympathetic, but they really do not have the time or the manpower within the small unit of business to establish and maintain pension plans. Is that right?

Mr. BERNSTEIN. That is correct, because the small businessman has his hands full these days as it is, without trying to solve these intricacies.

After 5 years of concentrated study, there are still areas of mystery to me. How a businessman would make an intelligent choice in this area, I just fail to see.

Senator RANDOLPH. Thank you.

Mr. BERNSTEIN. Moreover, small plans have the disadvantage of having small funds. This can be overcome in part by having pooled funds, but there are limitations upon that choice, as well.

Even perhaps more importantly, small employers provide a very rickety base for private plans, because they fail, unfortunately, and disappear at a very rapid rate.

It is surprising the number of enterprises there are in the United States. In 1962 there were more than 4.8 million individual firms. In the same year, 28,000 manufacturing firms alone shut down.

This is an area of employment that we tend to look upon as among the more stable. In retail trade and in service industries generally, the rate of failure and disappearance is great.

I suggest, then, that a principal problem, indeed the principal problem of extending private pension plan coverage, is to bring private-plan coverage within the reach of small employers.

What I suggest is a national small-group plan which employers would know is so dependable that they would have no hesitancy in including their employees under it, and in which they would be relieved of every burden except of making contributions.

The advantages of such a plan would be ease of choice, ease of administration, low overhead, and continuity, which is extremely important for private plans.

Under it, contributions would be made for individual employees, their records would be kept for them as they progress from small company to small company, their credits could be increased, their pension savings could be done effectually.

There are many different ways in which such a plan could be constructed. My own preference would be, and it is a considered one, for a national plan in which the Federal Government provided its highly effective, expert, widely admired system of collection of contributions and recordkeeping under the OASDI system. It would be a small matter to do this and to keep the records. It could be done at very low cost.

However, a key part of any pension plan is the way funds are invested. I think many, and I would share some of the misgivings, would question whether eventually a multibillion-dollar fund should be available to a Government agency for direct investment in private enterprise. I think it woud be unfortunate to limit the investment possibilities of such a fund; these considerations recommend, I suggest, the desirability of including the active participation of the private financial institutions and experts, including consultants, and union people to manage the fund, which would achieve, I suggest, a maximum security for the fund as well as maximum earnings.

Such a plan, I would also suggest, would help meet some of the other areas of sparse coverage such as farmers, part-time but regular workers which include women workers. As I pointed out, the present retirement income of women tends not to be reflected in their social security benefit because typically their benefits as wives exceed the benefits available to them from their own earnings, unfortunately. And a supplement for their present retirement income would seem desirable, as well, because they tend to be employed in the service and trade and retail areas, and among small employers.

A plan of this sort would reach them, as well. I think also it would help bring plan coverage closer within reach of low-wage employers. How low, I really could not estimate.

The urgency of this problem, Mr. Chairman, I think is not fully apparent.

I suggest that this committee closely question those who prepared the estimates of future coverage contained in the Cabinet Committee report to which you referred in your opening statement.

I think they are overly optimistic, and probably by a very considerable amount. They indicate that coverage which stood at about 23½ million persons in 1962, excluding retirees, will grow to over 42 million by 1980, and an increase in beneficiaries to over 6 million.

Most of those additional 6 million retirees will be those who are not presently retired, which means that coverage will have to about double in absolute numbers over the next 15 years. This would call for a rate of increase of almost 1½ million employees a year.

The Treasury reports that during the first 9 months of 1964 some 5,115 new pension plans were qualified; they covered 324,629 employees. Another 3,837 profit-sharing plans with 115,903 employees were qualified. Apparently this latter type of plan is not included in the Cabinet Committee report estimates.

In other words, the rate of actual growth during 1964 was about half of what the estimates of the Cabinet Committee report would call for.

Further, their report contemplated more rapid growth in the early years, rather than the later years.

A related problem surely is the reliability of plans to produce benefits. It does not matter how rapidly or widely coverage is spread, if indeed the plans will not achieve their goal to supply retirement benefits to large numbers of the retiring. As plans are presently constructed, a minority, very likely a very small minority, of those under plans will actually achieve benefit eligibility, and many of those who do will have those based on a relatively few years of employment. This is a significant factor, because typically single company plans which cover about 85 percent of the people under plans vary benefits in proportion to the years of service.

So I suggest that major steps be taken to improve the reliability of private plans, to improve their performance, to make it worthwhile to extend their coverage; indeed the plans we now have should be reconstructed. To this end I propose:

Rapid progress toward early vesting.

I suggest that the Cabinet Committee, this committee, or other interested governmental bodies and private bodies might consider establishing pension plan guideposts which would set benchmarks against which plans could be measured for their adequacy, both as to vesting and as to funding, because I suggest that the vesting recommended by the Cabinet Committee report is only minimal. It would have comparatively little impact and would in fact achieve not a great deal of improvement.

The establishment of a national pension clearinghouse, of which the national small group plan could be a part, would facilitate earlier vesting, because it would reduce its cost and would eliminate the administrative problems that now beset administering vesting provisions.

I earnestly suggest that a very practical early step that could be taken would be to make employee contributions to pension plans tax deductible. Because they are not deductible there has been a constant shift to noncontributory plans. However, contributory plans are typically far superior, both in their protective devices and in the benefits they pay.

The cost of such a change would really not be very great, if total contributions were not expanded. If they were expanded, the deductibility would only affect that part of the individual's contributions that would be taxable. A great deal of such contributions would not be taxable to the employee, to begin with. But the present tax law stands as a hurdle to the establishment of contributory plans.

Senator RANDOLPH. Mr. Bernstein, if the Internal Revenue Code were amended to make employee contributions to private pension plans deductible, would it not become necessary that contributions of Federal civilian employees to the Federal civil service retirement program also be made deductible?

Mr. BERNSTEIN. Such demands for equal treatment undoubtedly would be a difficulty of employing this approach, but I suggest it is not insuperable. The strong public interest in shoring up the reliability of private plans arguably may warrant separate treatment for them.

I further would suggest that adequate funding be made a condition of favorable tax treatment. The costs of an expanding program do not consist of the loss of revenue, because of employer contributions. The possible loss of revenue derives primarily from the fact that income of pension reserves and pension trust funds are by and large not taxable.

But I do suggest that this would be offset by the corporate earnings and the individual earnings that could be stimulated by the investment of these additional funds.

The majority of the elderly and those who enter their ranks in the years ahead will continue to be in need unless we take early action to improve the benefits of the public retirement plan, to also improve the coverage, and improve the effectiveness of private plans, as well.

Thank you.

Senator MORSE (presiding). In the absence of the chairman, Mr. Bernstein, I want to thank you on behalf of the committee for your statement. It is certainly bound to serve as the basis for a great deal of discussion in the executive session of this committee, and for a comparative analysis of it in connection with the other statements we are going to receive.

In fact, my tentative opinion in connection with this statement and other testimony is that we ought to do everything we can do to encourage the development of private pension plans, and we ought to interrelate them as much as possible with the Government services to the extent that Government services can be of assistance to the private plans, without in any way taking them over, so to speak.

But as you know, Mr. Norman, we are very much concerned in other subcommittees of this committee with the evidence we have received of the unfair advantages that are being taken of the elderly in so-called private plans in other fields.

I am going to call upon you, as counsel for this committee, when we finish the hearing to give us the evidence of the necessary checks that the Government must impose upon any private plan to see to it that the elderly are not taken advantage of.

Mr. NORMAN. Yes, sir.

Senator MORSE. Do not give me a memorandum that says they have a remedy in law, because that is a worthless remedy to someone getting $2,000 a year or less. The protection must be supplied for the individual, in my judgment, as a matter of social and public policy. The law should require Government surveillance to see to it that wrongdoers come in contest not with the individual pensioner, but with the Government itself.

At the same time, I think it is important to have such a guarantee or protection to protect the private plan that seeks to carry out its obligations of social conscience.

I want these plans to be financially sound for the benefit of the private segment of the economy, but I want them also to be so circumscribed by the Government that when there are legitimate charges of misuse or abuse or fraud or taking advantage of the elderly, the contest will not be with the individual pensioner, but with the Government.

I know that that is not going to be happily received in some quarters, but I believe our job in the Government is to protect the individual, and we cannot in the name of private enterprise permit so-called private pension plans to be checked only by the present broad scope of the law.

You are dealing with a problem here in which every taxpayer in the country has an interest, because if these elderly people are taken advantage of, they suffer the immediate consequences, but the burden ultimately falls back to the taxpayers, as a whole.

I do not know of a better witness to supply us subsequently, and there are others on the list that can, too, with a memorandum that will undoubtedly clear up some of my thinking on the matter, as I have been willing publicly to expose it this morning.

I do not want our private pension plans and the businessmen working in that field who are just as concerned about this as I am to have the private pension system itself sullied by a small group of charlatans.

Senator RANDOLPH. And this group does exist.

Senator MORSE. And I want to be sure, Mr. Counsel, before you ask me to vote on any recommendation of this committee that you have by special memorandums requested the information from these witnesses.

Mr. Bernstein talks about "guidelines." I am all for guidelines, but I want more than guidelines. I want the criteria set out so that they are guidelines, but they also provide enforcible protection to the employer and to the pensioner, the contributor, the worker, so that we are not going to set up a program here that can be taken advantage of.

Senator RANDOLPH. Thank you, Senator Morse.

Mr. Bernstein, you mentioned your national small group plan. In that connection, I am wondering how this would be organized, how it would be administered. Will it be by an insurance company, or a group or association of insurance companies? Would it be under the Social Security Administration?

Would you clarify this for me?

Mr. BERNSTEIN. It could be in any of the ways you suggest, plus some combination of public and private undertaking. It could be operated by the Social Security Administration. It could be operated wholly by a consortium of private financial institutions which would consist of insurance companies, and bank trust companies, and possibly some self-insured plans, as well.

They would in all likelihood need absolution from the antitrust laws, which would then lead to questions of how best such an operation could be regulated. I would think that it might best be operated by a governmental agency employing the OASDI machinery, which would set up the formal aspects of the plan, and the vital investment function of it would be done by those who do it best, the private financial institutions.

But there are several variations of public-private combination that conceivably are available for this purpose.

Senator RANDOLPH. Could the private employer, under your plan, merely sign up and make his contributions? Or would he have to have an attorney or an actuary and incur substantial expenses and go through complicated procedures to establish and maintain a pension plan?

Mr. BERNSTEIN. I do not think it would take any more than making contributions, which would in turn be translated into credits for the individual employees for whom they were made.

An employer would have to do no more than determine, possibly as a result of bargaining, what contributions should be made. He would have no burden beyond remitting those contributions; he would save on the very services you mention.

Senator RANDOLPH. It would not be an involved procedure under your plan?

Mr. BERNSTEIN. It would not. It would be quite simple and low cost, and more directly translated into benefits, rather than diverted to these nonbenefit costs.

Senator RANDOLPH. Thank you, Mr. Bernstein. You will follow the suggestion of Senator Morse on submitting further information for the committee, I am sure.

Mr. BERNSTEIN. Yes, sir.

(The text of letters subsequently received from Mr. Bernstein follow:)

YALE LAW SCHOOL,
New Haven, Conn., March 22, 1965.

Senator JENNINGS RANDOLPH,
Subcommittee on Employment and Retirement Incomes,
Special Committee on Aging,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In my March 4 testimony before the subcommittee I advocated a change in the tax laws so that employee contributions to qualified pension plans would be deductible from taxable income as employer contributions now are. So few wage earners itemize their deductions that an additional item of deduction would not in fact make equal the tax treatment of employee and employer contributions; to have the intended effect of equal treatment, employee contribution would have to be made exempt from taxation.

You immediately posed the question whether such a change would not necessarily also require equivalent treatment for other employee pension contributions, giving as an instance the substantial contributions Federal employees make to the civil service retirement system. I replied that perhaps separate treatment for private plans is warranted by the special public interest in improving private plans. And I should add that if limited to this one group the revenue loss would be relatively small.

I would now like to add the suggestion that exemption from taxation of all employee private and public retirement plan contributions (including social security and railroad retirement employee payroll taxes) would be a splendid way to effect a tax cut designed to stimulate consumer purchasing power. In 1958 the Treasury estimated that taxes would thereby be reduced about $2 billion, but this assumed that all individuals would avail themselves of this opportunity up to 7¼ percent of income. Taking into account how high this estimate was and the upward changes in income and the downward changes in tax rates (and the growth in population, hence exemptions for dependent children), the current figure would be no more and probably would be less. Some of the revenue loss could be recaptured, primarily from those with large postretirement income, if all public and private benefits were made taxable as income upon receipt.

Such action might be desirable both as fiscal action to stimulate the economy and as a practical means to promote retirement savings.

Sincerely,

MERTON C. BERNSTEIN.

YALE LAW SCHOOL,
New Haven, Conn., March 23, 1965.

Senator JENNINGS RANDOLPH,
Subcommittee on Employment and Retirement Incomes,
Special Committee on Aging,
U.S. Senate, Washington, D.C.

DEAR SENATOR RANDOLPH: In my statement to the subcommittee on March 4 I noted, as did some other witnesses thereafter, that the per capita cost of pension plans covering small groups were significantly higher than the per capita costs for large groups.

I now wish to submit for inclusion in the record some specific examples of comparative costs of groups of varying size which an insurance company kindly prepared at my request. In all likelihood essentially the same size-cost relationship would exist in noninsured trusteed plans employing the same assumptions.

Sincerely,

MERTON C. BERNSTEIN.

Per man costs

Size group in lives	Average cost age		
	40	45	50
Group A—Benefit $160 a month:[1]			
10	$540	$665	$825
25	499	620	780
50	482	604	762
100	474	596	754
170 and larger	471		
135 and larger		594	
110 and larger			753
Pure cost, no expense	448	565	715
Group B—Benefit $100 per month:[2]			
10	365	442	542
25	324	399	498
50	307	384	482
100	299	376	474
275 and larger	294		
220 and larger		371	
170 and larger			471
Pure cost, no expense	279	352	448

[1] This assumes an average of 40 years of service at retirement.
[2] This assumes an average of 25 years of service at retirement.

COMMENT

1. The "larger" costs represent the point where the contract charge is no longer a factor.
2. Our typical case has a cost age of about 45.
3. If some turnover were assumed the costs shown for an average age of 40 could be reduced by about 10 percent; for the age 45 costs by about 5 percent; and for the age 50 no change as turnover is not likely to be meaningful in a group of that maturity.

Senator RANDOLPH. Miss McCamman, you previously served as a professional staff member of the Special Committee on Aging. We are glad to welcome you back to the committee this time as a witness. We are delighted to have you.

STATEMENT OF CHARLES I. SCHOTTLAND, DEAN, FLORENCE HELLER GRADUATE SCHOOL FOR ADVANCED STUDIES IN SOCIAL WELFARE, BRANDEIS UNIVERSITY; CHAIRMAN, SUBCOMMITTEE ON RETIREMENT INCOME, THE NATIONAL COUNCIL ON THE AGING, REPRESENTED BY MISS DOROTHY McCAMMAN

Miss McCAMMAN. I am delighted to be back, Senator. I enjoyed my services on the committee.

Senator MORSE. Have you inspected any nursing homes recently?

Miss McCAMMAN. No. Have you purchased any rocking horses for your grandchildren recently? [1]

I am appearing before the Subcommittee on Employment and Retirement Incomes in behalf of the National Council on the Aging, of which Dean Schottland is chairman of our subcommittee on retirement income.

Dean Schottland regrets his inability to be present here today. As you may know, he has been devoting his skill to the very difficult job of arbitrating the New York City welfare employees strike. He is now offering this statement. He will, as soon as he is able to catch his breath, submit written answers to your questions or any further questions that the committee may wish to ask.

Senator RANDOLPH. We will consider his statement as read, and you may make what comments you wish.

Miss McCAMMAN. Very good.

(Statement prepared by Dean Schottland follows:)

STATEMENT OF CHARLES I. SCHOTTLAND, CHAIRMAN OF SUBCOMMITTEE ON RETIREMENT INCOME, THE NATIONAL COUNCIL ON THE AGING

I am delighted to have this opportunity to participate in the hearings of the Subcommittee on Employment and Retirement Incomes of the Senate Special Committee on Aging. During recent years, the Special Committee on Aging has made an outstanding contribution through its studies of problems of older Americans and its recommendations for legislation and other measures to improve the well-being of our senior citizens. You are to be congratulated for now turning your attention to an intensive inquiry into the important subject of private pension plans and Federal policies to encourage the pension coverage of those not now protected.

With your permission, I shall first make a general statement as chairman of the Retirement Income Subcommittee of the National Council on the Aging's Committee on Employment and Retirement.

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[1] Reference is to site visits in connection with the Eugene, Oreg., hearing, Nov. 8, 1961.

You are undoubtedly already familiar with the National Council on the Aging as the national voluntary agency for consultation and planning in the field of aging.

NCOA brings together in its membership representatives of management and labor and of governmental and voluntary agencies. It provides a unique rallying point for leadership planning and action in behalf of the older citizen. NCOA's Committee on Employment and Retirement has for many years been concerned with policies and programs in the area of employment of older workers, and preparation for retirement and criteria for retirement. The subcommittee on retirement income was formed about 2 years ago to round out a coordinated approach to the total problem of older workers, their retirement and their income in retirement.

Perhaps you would be interested to have for the record a list of the membership of the retirement income subcommittee of which I am privileged to be the chairman.

COMMITTEE ON EMPLOYMENT AND RETIREMENT

Chairman: Edwin F. Shelley, vice president, U.S. Industries, Inc., New York.

Vice chairman: Dr. Juanita M. Kreps, Department of Economics, Duke University, Durham, N.C.

SUBCOMMITTEE ON RETIREMENT INCOME

Chairman: Charles I. Schottland, dean, School for Advanced Studies in Social Welfare, Brandeis University, Waltham, Mass.

Vice Chairman: Benjamin B. Kendrick, director of health insurance research, Life Insurance Association of America, New York.

Members

Robert C. Beetham, research director, Teachers Insurance & Annuity Association, New York.

Orville F. Grahame, vice president and general counsel, Paul Revere Life Insurance Co., Worcester, Mass.

Edwin Shields Hewitt, partner, Hewitt Associates, Libertyville, Ill.

Leonard Lesser, director of social security activities, Industrial Union Department, AFL–CIO, Washington, D.C.

Dr. Hazel S. McCalley, vice president, Greenleigh Associates, New York.

Miss Dorothy McCamman, consultant on retirement income, the National Council on the Aging.

Dr. John W. McConnell, president, University of New Hampshire, Durham, N.H.

Dr. Roger F. Murray, S. Sloan Colt professor of banking and insurance, Graduate School of Business Administration, Columbia University, New York.

Robert J. Myers, chief actuary, Social Security Administration, Department of Health, Education, and Welfare, Washington, D.C.

Robert D. Paul, senior vice president, Martin E. Segal Co., New York.

Wm. H. Wandel, director of research, Nationwide Insurance Co., Columbus, Ohio.

You will note that we have several outstanding authorities on the subject of private pensions: Edwin Shields Hewitt, president of Hewitt Associates; Dr. Roger F. Murray, of Columbia University; Robert J. Myers, Chief Actuary of the Social Security Administration, and Robert D. Paul, senior vice president of Martin E. Segal & Co.

When our subcommittee was formed, we planned to focus our attention initially on private pension plans, their contribution to retirement income and their relationship to the social security program. Because the subcommittee's role is to fill gaps and not to duplicate studies carried out elsewhere or to conduct intensive investigations, our study of private pension plans was postponed awaiting availability of the report of the President's Committee on Corporate Pension Funds.

As you know, this report "Public Policy and Private Pension Programs" was not issued until mid-January. Therefore, our subcommittee has not yet had an opportunity to evaluate the recommendations of the President's Committee. Nevertheless, the work already done by the subcommittee in identifying the issues and policies that affect the income of older people provides a frame of reference for consideration of this important report on private pensions. I am submitting for the record or for your files a copy of our draft statement on "Issues and policies concerning the income position of older persons," [2] along with our working document, "Background facts on the income position of older persons."

We are not testifying today as experts on the details of private pension plans —although our retirement income subcommittee obviously includes a number of persons qualified to do so. We are directing our statement instead to the role of private pensions, at present and potentially, in providing retirement income and to the essential interrelationships with the national social insurance program. Nor are we relating our testimony to specific legislative proposals. We are concerned instead with basic public policy issues and the principles that should guide the decisions on these issues.

I understand that the hearings you are now holding are focused on proposals for extending coverage under private pension plans and that future hearings may be held on such questions as vesting provisions and funding. Obviously, it is impossible to encompass all the complexities of private pension plans, by themselves, and in relation to other programs, in 2 days of hearings. But equally obviously (and I'm sure that I do not need to belabor this point with a group as knowledgeable as yours), coverage is meaningful only if it gives rise to benefits. Indeed, coverage that cannot reasonably be expected to result in any benefit for any large portion of covered workers may be worse than no coverage at all in that it gives a false feeling of security to workers individually and to others responsible for formulating policies related to retirement income.

BACKGROUND FACTS

I would like to present briefly the background facts against which the subcommittee formulated its statement of the issues relating to private pensions.

Beneficiaries of private pension plans now number nearly 2½ million. This includes an unknown number of retired and disabled workers under age 62 and widows. It is estimated that pensioners aged 65 and over and their dependent wives total 2.6 million or 14 percent of the population 65 or over.

Persons receiving private pensions have considerably higher incomes than do other old-age, survivors, and disability insurance beneficiaries. The median total income for married couples with a private persion in 1962 as measured by the Social Security Administration's recent survey, was $3,400—only one-sixth less than that of beneficiary couples with at least one member working at a full-time job. And for nonmarried beneficiaries, a private pension did as much as full-time employment to raise the average level of money income. The higher retirement income reflects not only the actual receipt of a private pension but also higher preretirement earnings.

It is clear then that private pension plans represent a tremendous potential for raising the level of private resources available during retirement. It is equally clear that most older people cannot expect to participate in this source of retirement income in the foreseeable future unless the growth of private plans can be markedly accelerated. Assuming continued development of pension plans without significant change in the present legal framework that affects them, beneficiaries of private plans are expected to number 6.6 million by 1980. Aged pensioners and their wives would then account for just under three-tenths of the population 65 or older. Coverage, under the same assumptions, is expected to rise by 1980 to 42 million workers (60 to 65 percent of all employees of private nonfarm establishments).

THE ISSUES

In the effort to accelerate the growth of private pensions as a basic essential of economic security, various proposals have been advanced over the years. The report of the President's Committee has now focused public attention on a number of specific proposals, particularly those involving changes in legislation.

I wish to emphasize that NCOA's Retirement Income Subcommittee is not directing its statement to these specific proposals. We are instead identifying what we think are the basic considerations for use in assessing all proposals to stimulate further the development of private plans and to guard against losses of protection.

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[2] See Appendix, p. 152.

The basic issue, as defined by our subcommittee, is essentially this: What measures will encourage and stimulate the continued development of private plans, avoiding the imposition of heavy costs or other burdens that tend to stifle healthy growth?

Our subcommittee then went on to define a number of specific questions which, because of interrelatedness, I shall present as stated before commenting on those of particular concern to your subcommittee. These questions are:

(*a*) What are the effects of various governmental regulatory measures on the growth of private plans?

(*b*) What are the appropriate interrelationships of private plans and the basic social insurance program that should shape the further development of both types of protection?

(*c*) How can private pension plan coverage be extended to employees of small firms which find it difficult and costly to set up and administer a one-employer plan?

(*d*) How can pension rights already earned be preserved during job shifts or when employment is terminated because the company relocates, consolidates, goes out of business, or automates and reorganizes?

(*e*) How can the financial base of private plans be strengthened, thus assuring that they will be able to deliver promised benefits?

(*f*) What are the costs of various improvements in private pension plans—for example, vesting or provisions for earlier retirement—and what are the priorities among these improvements? What are the priorities when pension plan improvements are weighed against other types of employee benefits?

I am keenly aware of the importance of each of the three essential elements of retirement security: The basic national governmental program of old-age survivors and disability insurance; private pension plans established through voluntary, group action; and personal savings through individual effort. Each has its important role and these roles should be complementary and not competitive. Each should be encouraged, not stifled.

Fears, expressed at the time the Social Security Act was debated, of a substitution of public retirement provisions for the emerging interest in private pensions, have long since been laid to rest. The public plan has clearly encouraged the growth of supplementary plans by providing a foundation on which meaningful protection can be built.

Similarly, we now have evidence that private pension plan coverage does not, on the average, lead families to reduce their savings in other forms. The National Bureau of Economic Research has surveyed a group, paired in as many characteristics as possible but differing in whether they were covered by a private pension plan. The ratio of other savings to income was at least as high for those covered by private pension plans as for those not covered, leading the national bureau to conclude:

"It appears that pension coverage has a 'recognition effect.' It is true that in certain groups, notably those with high employee contribution rates and full vesting, there is some substitution of pension savings for savings in other forms. But those who react in this way are fully offset by those whose reaction is to increase other savings. The composite picture, therefore, is one of a net addition to personal saving of the full amount of pension accumulations. That is to say, realization of retirement needs and of the opportunities for financial independence opened up by a pension stimulate the motivation to save."

Our retirement income subcommittee, in discussing these findings speculated on other reasons why pension plan coverage does not reduce additional personal savings. Among these explantions is the possibility that the concept of saving for retirement is not firmly established among the working population; in other words, the purpose of saving may be—not for retirement—but for a more imminent rainy day. Another possibility is that stock ownership is becoming almost a prerequisite to full participation in the everyday conversation of the more affluent members of our society. And, related to the "recognition effect" mentioned above and to the effect of the Social Security Act in stimulating the development of private plans, the private pension brings financial security within reach and therefore provides motivation for additional savings. The point has not yet been reached (and it is questionable whether it should ever be reached) when the level of income to be expected from retirement benefits is high enough to make other forms of saving unnecessary.

I might mention briefly the major characteristics of our social insurance system that have influenced the design of private pension plans and that are important to the complementary relationships of the public and private systems.

The coverage of old-age survivors and disability insurance is almost universal. Credit earned under the basic programs are not lost through changes of employment. The capacity to finance benefits rests on the entire economy, not just on a single firm or industry. Benefits are broad in scope, including protection for survivors of young workers and for the dependents and survivors of retired workers. The basic benefit, designed to replace a higher proportion of the earnings loss of low-paid workers than of those with higher earnings, is not graduated by length of employment. The total earnings which determine both contributions and benefits are subject to a maximum.

Because the emphasis in the public program is on basic retirement income for all workers, private pension plans have an essential role to play in making possible a more adequate retirement income in relation to past earnings. In building on the protection provided by the public system, private plans frequently will allow a higher benefit on earnings that are above the base credited by the social security system. The private pension plan, with its greater flexibility, can be adjusted to the special conditions of the company or industry, for example through provisions for retirement at an earlier age than is possible under the uniform basic system.

In the years ahead, more and more workers will be eligible on retirement for private pensions—and, hopefully, deliberations like these hearings will open the doors to new solutions for ever broader coverage. Nevertheless private plan protection will always be far from complete and, in the words of the President's Committee on Corporate Pension Funds:

"The public program will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows and dependents."

It is on this premise that decisions as to the adequacy of social security benefits must be made—not on the optimistic but ungrounded hope that virtually all workers will receive a private pension in addition to the social security benefit. It is on this premise that we must also assess the eligibility age for full retirement benefits under the social security program—not on the expectation that private plans with their greater flexibility will of course jump into the breach to provide retirement income for the worker who is unable to continue on the job until eligibility for old-age insurance benefit.

We have long been aware that the combined level of benefits under OASDI and private pension plans should be reasonably related to wage levels and living standards. We are now becoming increasingly aware of the interrelationship with respect to eligibility age for full benefits and provisions for early retirement.

As your subcommittee knows all too well, older workers are finding it increasingly hard to hold onto their jobs until retirement age. In recognition of this reality, the social security program has been amended to provide reduced benefits for workers retiring before age 65. Significant proportions of workers have claimed these lower benefits, apparently because their limited earnings made even a reduced benefit attractive. And although it might be expected that a larger proportion of each successive age group reaching retirement would have rights to a private pension, the Social Security Administration's 1963 survey shows that private pensions were received by relatively fewer of these early retirants than of workers retiring after age 65.

Some of our largest private pension plans have recognized this same problem by liberalizing their provisions to encourage early retirement in general and to provide, in the case of plant shutdowns, early retirement benefits that are larger than the actuarial equivalent of the normal retirement benefit. Provisions like these have their price tag; when decisions are made about improvements in private pensions—or when the cost of pensions is weighed against costs of other employee benefits—the cost of early retirement represents a competing claim with such costs as vesting and higher benefit levels.

These are some of the interrelationships of private plans and the basic social insurance program that should be taken into consideration in making the public policy decisions that will shape the further development of both types of protection.

Miss McCamman. I am also submitting for your record or for the files, copies of materials prepared by our retirement income subcommittee, a statement on the issues and policies affecting the incomes of the aged,[3] and a statement of background facts.

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[3] See Appendix, p. 152.

Senator RANDOLPH. The subcommittee will determine what portions of that material could well be fitted into the hearing and also what portions could be of value to the subcommittee in drafting a report.

Thank you.

Miss McCAMMAN. I shall, then, read briefly from the prepared statement, starting in the middle of page 35. We say:

In the effort to accelerate the growth of private pensions as a basic essential of economic security, various proposals have been advanced over the years. The report of the President's Committee has now focused public attention on a number of specific proposals, particularly those involving changes in legislation.

I wish to emphasize that NCOA's retirement income subcommittee is not directing its statement to these specific proposals.

I might point out, however, that we have a number of members of our subcommittee who will be testifying: Mr. Leonard Lesser, Dr. Roger Murray, and Mr. Edwin Shields Hewitt will be testifying to your subcommittee.

We are instead identifying what we thing are the basic considerations for use in assessing all proposals to stimulate further the development of private plans and to guard against losses of protection.

The basic issue, as defined by our subcommittee, is essentially this: what measures will encourage and stimulate the continued development of private plans, avoiding the imposition of heavy costs or other burdens that tend to stifle healthy growth?

Our subcommittee then went on to define a number of specific questions which, because of interrelatedness, I shall present as stated before commenting on those of particular concern to your subcommittee. These questions are:

(*a*) What are the effects of various governmental regulatory measures on the growth of private plans?

(*b*) What are the appropriate interrelationships of private plans and the basic social insurance program that should shape the further development of both types of protection?

(*c*) How can private pension plan coverage be extended to employees of small firms which find it difficult and costly to set up and administer a one-employer plan?

(*d*) How can pension rights already earned be preserved during job shifts or when employment is terminated because the company relocates, consolidates, goes out of business, or automates and reorganizes?

(*e*) How can the financial base of private plans be strengthened, thus assuring that they will be able to deliver promised benefits?

(*f*) What are the costs of various improvements in private pension plans—for example, vesting or provisions for earlier retirement—and what are the priorities among these improvements? What are the priorities when pension plan improvements are weighed against other types of employee benefits?

I am afraid I may have just added to the list of questions which you had already prepared.

Dean Schottland, as a former Commissioner of Social Security, is keenly aware of the importance of each of the three essential elements of retirement security: the basic national governmental program of old-age, survivors, and disability insurance; private pension plans established through voluntary, group action; and personal savings through individual effort. Each has its important role, and these roles should be complementary and not competitive. Each should be encouraged, not stifled.

Fears, expressed at the time the Social Security Act was debated, of a substitution of public retirement provisions for the emerging interest in private pensions, have long since been laid to rest. The public plan has clearly encouraged the growth of supplementary plans by providing a foundation on which meaningful protection can be built.

Similarly, we now have evidence that private pension plan coverage does not, on the average, lead families to reduce their savings in other forms. The National Bureau of Economic Research has surveyed a group, paired in as many characteristics as possible but differing in whether they were covered by a private pension plan. The ratio of other savings to income was at least as high for those covered by private pension plans as for those not covered, leading the National Bureau to conclude:

> It appears that pension coverage has a "recognition effect." It is true that in certain groups, notably those with high employee contribution rates and full vesting, there is some substitution of pension savings for savings in other forms. But those who react in this way are fully offset by those whose reaction is to increase other savings. The composite picture, therefore, is one of a net addition to personal saving of the full amount of pension accumulations. That is to say, realization of retirement needs and of the opportunities for financial independence opened up by a pension stimulate the motivation to save.

Our retirement income subcommittee, in discussing these findings, speculated on other reasons why pension plan coverage does not reduce additional personal savings. Among these explanations is the possibility that the concept of saving for retirement is not firmly established among the working population, in other words, the purpose of saving may be—not for retirement—but for a more imminent "rainy day."

Another possibility is that stock ownership is becoming almost a prerequisite to full participation in the everyday conversation of the more affluent members of our society. And—related to the "recognition effect" mentioned above and to the effect of the Social Security Act in stimulating the development of private plans—the private pension brings financial security within reach and therefore provides motivation for additional savings.

The point has not yet been reached, and it is questionable whether it should ever be reached, when the level of income to be expected from retirement benefits is high enough to make other forms of saving unnecessary.

I might mention briefly the major characteristics of our social insurance system that have influenced the design of private pension plans and that are important to the complementary relationships of the public and private systems.

The coverage of OASDI is almost universal. Credits earned under the basic programs are not lost through changes of employment. The capacity to finance benefits rests in the entire economy, not just on a single firm or industry. Benefits are broad in scope, including protection for survivors of young workers and for the dependents and survivors of retired workers.

The basic benefit, designed to replace a higher proportion of the earnings loss of low-paid workers than of those with higher earnings, is not graduated by length of employment. The total earnings which determine both contributions and benefits are subject to a maximum.

Because the emphasis in the public program is on basic retirement income for all workers, private pension plans have an essential role to play in making possible a more adequate retirement income in relation to past earnings.

In building on the protection provided by the public system, private plans frequently will allow a higher benefit on earnings that are above the base credited by the social security system.

The private pension plan, with its greater flexibility, can be adjusted to the special conditions of the company or industry, for example through provisions for retirement at an earlier age than is possible under the uniform basic system.

In the years ahead, more and more workers will be eligible on retirement for private pensions—and, hopefully, deliberations like these hearings will open the doors to new solutions for ever-broader coverage. Nevertheless, private plan protection will always be far from complete and—in the words of the President's Committee on Corporate Pension Funds:

> The public program will continue to be the Nation's basic instrument for assuring reasonably adequate retirement income to workers, their widows, and dependents.

It is on this premise that decisions as to the adequacy of social security benefits must be made—not on the optimistic but ungrounded hope that virtually all workers will receive a private pension in addition to the social security benefits.

It is on this premise that we must also assess the eligibility age for full retirement benefits under the social security program—not on the expectation that private plans with their greater flexibility will of course jump into the breech to provide retirement income for the worker who is unable to continue on the job until eligibility for old-age insurance benefits.

We have long been aware that the combined level of benefits under OASDI and private pension plans should be reasonably related to wage levels and living standards. We are now becoming increasingly aware of the interrelationship with respect to eligibility age for full benefits and provisions for early retirement.

As your subcommittee knows all too well, older workers are finding it increasingly hard to hold onto their jobs until retirement age. In recognition of this reality, the social security program has been amended to provide reduced benefits for workers retiring before age 65.

Significant proportions of workers have claimed these lower benefits, apparently because their limited earnings made even a reduced benefit attractive. And although it might be expected that a larger proportion of each successive age group reaching retirement would have rights to a private pension, the Social Security Administration's 1963 survey shows that private pensions were received by relatively fewer of these early retirees than of workers retiring after age 65.

Some of our largest private pension plans have recognized this same problem by liberalizing their provisions to encourage early retirement in general and to provide, in the case of plant shutdowns, early retirement benefits that are larger than the actuarial equivalent of the normal retirement benefit.

Provisions like these have their price tags. When decisions are made about improvements in private pensions—or when the cost of pensions is weighed against cost of other employee benefits—the cost of early retirement represents a competing claim with such costs as vesting and higher benefit levels.

These are some of the interrelationships of private plans and the basic social insurance program that should be taken into consideration in making the public policy decisions that will shape the further development of both types of protection.

Senator RANDOLPH. Thank you, Miss McCamman.

You have indicated some of the persons within your organization we will have the opportunity to hear, so we will allow the statement of Dr. Schottland as read by you to suffice.

We are very grateful for your presence.

Thank you.

(The following supplementary statement was subsequently submitted by Dean Schottland.)

DEAN CHARLES I. SCHOTTLAND'S ANSWERS TO QUESTIONS ASKED BY SUBCOMMITTEE ON EMPLOYMENT AND RETIREMENT INCOMES

You ask me to comment on the following questions:

1. "Is it a wise and proper activity of the Federal Government to encourage the extension of private pension coverage to more of its citizens and to seek to increase the amount of private pension income received in retirement?"

My answer is "Yes."

I sincerely believe that it is a wise and proper activity of our Federal Government to *encourage* the extension of private pension coverage and to *seek to increase* retirement income received from these plans. I emphasize "encourage" and "seek to increase." Whatever measures the Federal Government adopts in this worthwhile endeavor must be most carefully designed to insure that they will encourage and stimulate the continued healthy development of private plans. Measures which impose such heavy financial or other burdens as to stifle the growth of private pension plans are obviously self-defeating.

The Federal tax laws and the tax advantages that have been granted to private pension plans have undoubtedly contributed significantly to their past growth. It is reasonable to assume that plans would continue to grow under this type of Federal legislation. But increasingly, we are faced with the further question of whether the coverage provided under some of these plans is really effective; does the law and its administration provide sufficient safeguards to the covered employee and his interest in these plans—safeguards that are also in the public interest because of the importance of private pension income as an essential element of retirement security? As I pointed out in my statement on behalf of the National Council on the Aging: "Coverage is meaningful only if it gives rise to benefits. Indeed, coverage that cannot reasonably be expected to result in any benefit for any large portion of covered workers may be worse than no coverage at all in that it gives a false feeling of security to workers individually and to others responsible for formulating policies related to retirement income."

We have two objectives, I think: to extend coverage and to protect the employee's interest in his future retirement income. To achieve both these objectives requires a most delicate balance because there are different advantages for the employer and his employee, which lead directly to your second question.

2. "What advantage do private pensions offer from the standpoint of the employee? The employer? The Federal Government?"

In the interests of brevity and at the risk of oversimplification, I would say that a private pension plan offers the employee a chance at an adequate income in retirement—this in essence is the advantage to the Federal Government in its concern for the economic security of the aged—and it helps an employer to raise employee morale and to hold his senior and valued employees. These interests can sometimes work as cross-purposes. If the employee is to receive a private pension in retirement that recognizes the typical lifetime working pattern, the pension must be based on employment for a number of employers; there must be some degree of vesting. But vesting provisions encourage mobility—or at least do not impede movement from job to job—and can, therefor, work against the interests of the employer who wishes to retain his experienced workers.

Vesting costs money: so does the funding which assures that an employee would receive his pension on retirement even if his former employer were to go out of business. Federal regulations that require vesting and funding could, therefor, serve to discourage an employer from setting up or continuing a private pension plan. Vesting and funding, while essential elements in a plan that guarantees that workers will realize their expectations of benefits, are of no real advantage to the employer and may even work to his disadvantage. The advantage to the employee is not always clear—especially in his early working years—and may fade away when stacked up against the compelling costs of higher benefits for career employees or of early retirement provisions.

4. "Is the revenue loss more in the nature of a 'tax loophole' which permits some to avoid paying their fair share of taxes; or is it more in the nature of a sound investment in the future retirement incomes of our senior citizens and in the future economic stability and prosperity of Americans of all ages?"

I do not believe that the exemption of taxes on employer contributions to pension funds should be considered a "tax loophole." We must remember that pension plans are in the interest of the employee and of the general public too. In fact, an employer could put the same amount of money into wages or other fringe benefits—or indeed into advertising of his product—and take equivalent tax deductions as a cost of carrying on his business. Contributions to private pension plans are, in my opinion, an investment in future retirement security. Therein lies the public interest in assuring that private pension plans will achieve their full potentials in coverage and benefit payment.

5. "To what extent is the revenue loss offset by decreased Federal expenditures; such as, those for public assistance?"

Offsets like this are not subject to measurement in dollars and cents. It would probably be difficult if not impossible to prove that private pension coverage materially reduces public assistance expenditures. Actually, older persons now receiving private pensions have higher than average retirement incomes, due in part to the pension and in part to higher earnings during their working lifetimes, and are, therefore, least likely to need supplementation through public assistance. Private pension plans, if they can be extended to cover employes in small firms and those who do not usually stay with an employer long enough to acquire rights to a pension under existing provisions, would encompass significantly more of the group potentially in need of public assistance in their old age.

8. "What Federal statutes, regulations, and administrative actions and policies would contribute to the extension of private pension coverage at reasonable Federal costs?"

I have no specific proposals to offer in answer to this question, especially since it requires expert knowledge to determine "reasonable Federal costs." I would like to make a general observation, however, to the effect that the overriding consideration in assessing all such proposals is that they *contribute* to the extension of private pension coverage by avoiding unduly restrictive Federal legislation or policies. We must keep constantly in mind the voluntary nature of private pensions plans. Reference is sometimes made to the role *assigned* to private pensions in providing economic security. Terminology like this implies a guarantee or commitment on the part of the private plan to produce a given level of benefit; a guarantee that would require compulsion and is, therefore, incompatible with the whole concept of voluntary plans. Only the basic social insurance program can provide the *guarantee* of assured income for our working population after retirement.

9. "What are the special problems of extending coverage to farmers and their employees or coworkers, and is any Federal action with reference to such coverage feasible?"

Several years ago, Senator McNamara, chairman of your Senate Committee on Aging, released an excellent analysis of the income position of our farm population which provides much of the answer to this question. The low cash income of farmers and farmworkers places supplementary retirement income beyond the reach of the great majority, even if it were feasible to work out an arrangement for group coverage accompanied by tax incentives or some form of central clearinghouse for pension credits. For the bulk of the farm population our basic social insurance program will provide the only assured source of income in old age.

Senator RANDOLPH. Thank you, Dr. Murray, for coming before our subcommittee. We are happy to have the benefit of your study of this problem.

We know of your professorship at Columbia University. I do not know whether you want to comment on this word "thrift" or not. They say it is a word that is not in such good usage as it once was in our American society.

What do you think about it, sir?

STATEMENT OF DR. ROGER F. MURRAY, PROFESSOR OF BANKING AND FINANCE, COLUMBIA UNIVERSITY, REPRESENTING THE AMERICAN THRIFT ASSEMBLY

Dr. MURRAY. I think it is still in good standing when we come to study the problem of retirement income, which is essentially a problem of thrift, or spreading the income over the working life into the retirement period for individuals and their families.

Senator RANDOLPH. Do you wish to identify your assembly? I would just like to know more about the American Thrift Assembly. I think the subcommittee might. Would you give us just a brief explanation?

Dr. MURRAY. Yes, sir. The American Thrift Assembly was organized in 1957 as a medium through which a number of associations of self-employed individuals could mobilize their support of the original H.R. 10, which was finally enacted as the Smathers-Keogh bill.

Senator RANDOLPH. Has that bill worked out in practice following its enactment into law?

Dr. MURRAY. It certainly has not, sir. That is one of the things that I would like to point to specifically.

Senator RANDOLPH. You heard my earlier comment regarding what I had heard from an attorney. He had hopes for this legislation, but he said it had failed.

Dr. MURRAY. Among attorneys, I am told that in some preliminary efforts to organize plans for lawyers, the participation has been virtually negligible up to the present time.

I think that whether we refer specifically to the currently popular term "the Great Society" or to more traditional concepts of human dignity, we all share, I believe, an earnest desire to see our fellow citizens enjoy the opportunity to live out their years with a minimum of dependence upon relatives, friends, or governmental assistance programs.

The ability to care for one's self, to be independent of charity, however graciously bestowed, is the primary source of dignity and self-respect for our senior citizens.

It is in recognition of this basic objective that we as citizens have used the instrumentalities of the Federal Government to provide, first, a basic level of income through the old-age and survivors insurance system, and, second, carefully designed incentives for the establishment of supplemental retirement income plans.

Units of government at Federal, State, and local levels have been leaders in developing these plans. The fact that a Government employee is not taxed currently on his employer's contribution to a retirement system or on the value of a pension promise is a tax benefit deliberately designed to discriminate between regular current salary income and additional income in the form of sums to be paid later as retirement income.

Private business organizations can qualify similar plans under the stringent regulations of the Treasury Department.

Tax deferment, then, has been selected, as a matter of deliberate policy over many years, to provide an incentive to the establishment of systematic provision for supplemental retirement income.

I can think of no better way for us to deal with the problem, and I see no reason for anyone to blink at the carefully thought-out, time-tested provision of tax incentives to prepare in an orderly way for the known eventuality of old age.

I lose patience with those who speak of "revenue loss" in regard to public and private pension program as though this were some kind of tax loophole. Two centuries ago in England there was a tax on windows. Do we count it a revenue loss that we do not now tax the entrance of sunlight into people's homes?

Nor do we tax as income to the recipient a State grant of scholarship aid for education, even though we know that the student will gain future income by reason of his training. We do not tax any portion of OASDI benefits, even those attributable to the employer's tax payments.

We exclude from tax the second as well as the first $600 of an individual's income when he is over 65. Are these examples of tax loopholes? Or are they simply instances of a conscious effort to allocate more of the income tax to working years and less to years of retirement?

I am sure that I do not need to argue this point further before this committee, but I think it is time that we stopped apologizing for not taxing the accumulation of retirement income benefits for members of the Armed Forces, wage earners, civil servants, businessmen, U.S. Senators, and college professors.

On the contrary, we should be proud of and seek to improve our pension structure, both public and private, on the pragmatic basis that it works well for all those who participate in it.

Briefly, we can identify several distinct advantages of our pension structure:

1. It provides equitable treatment among individuals according to the contribution made to the organization served.
2. It enables the employer to budget systematically the costs of pension benefits.
3. It offers greater assurance that pension promises will be fulfilled.
4. It permits appropriate regulation by the Federal Government of the terms and conditions of the pension arrangements, at least in the case of private and Federal employee plans.
5. It encourages families to save voluntarily for financial independence in retirement.
6. It affords a major contribution to the maintenance of individual incomes in reinforcement of our efforts to achieve economic growth and stability.

It is estimated that about 25 million employees are covered by private plans, or about one-half of those working in private nonfarm activities. About 1 million more employees are covered each year. The coverage is much higher in Government, but we might wish that many more families in private industry were covered.

The question, then, is: what might be done to extend coverage? There are no easy answers, as has been pointed out, because most of the large groups of full-time employees, the obvious cases, are already being covered. Some sizable fraction of the labor force, notably women who enter and leave it, depending upon family responsibilities, will probably never be covered. If their husbands are covered, however, we need not be too concerned about them.

Another sizable number of uncovered workers is composed, of course, of the unskilled, underemployed seasonal and casual workers in which minority groups bulk especially large.

The problem here, however, is not pension coverage, but the nature of employment. Our governmental and private programs of education and training are the vital factors in bringing them into more productive activities. If these programs are successful, many of them will secure pension coverage.

In a very real sense, the antipoverty program is a proretirement income program. Its success will contribute to a progressive extension of pension coverage.

Thus, a major problem from here on is the long-range effort to better living standards for minority groups and other unskilled workers.

But one step can be taken now. I refer to the extension of coverage among the 9 million self-employed and their 9 million employees. This is by far the largest group for whom coverage can be made a practical reality in the near future.

Passage of the Smathers-Keogh bill about 2 years ago marked the first step in removing the longstanding discrimination against the self-employed. However, the original proposal was amended to cut in half the tax deductibility of contributions to qualified plans up to $2,500 a year, or 10 percent of earned income, whichever is less, made on behalf of self-employed individuals.

The incentive for the self-employed to begin to provide systematic pension coverage for themselves and for their employees was greatly reduced by this amendment.

If the Treasury Department is able to give you any figures on the extent of participation, I am sure you will be surprised at how few self-employed have acted. I have no doubt that the Treasury's estimates, made in advance of passage of the Smathers-Keogh bill, greatly overestimated the response.

The self-employed individual as an employer of his own services occupies the same position as the manager of a small business employed by a corporation. There is no reason, as a matter of equity, why that portion of his compensation which is committed for the provision of retirement income should not be treated exactly alike in both cases.

Removal of the present inequitable treatment would do much to encourage the extension of pension coverage to both the self-employed and their employees.

A bill to accomplish this objective, appropriately identified as H.R. 10, has been introduced in the present session of the 89th Congress by Eugene Keogh, of New York.

I am sure that the support of this bill by your committee would be most welcome, because you are particularly concerned with the potential benefits of extending the range of incentives for systematic provisions for retirement income supplementary to the basic old-age and survivors insurance system.

The passage of H.R. 10 in the present session would be a powerful stimulant to the self-employed to take action in the matter. But I emphasize that it takes time to educate and stimulate people to undertake such long-term saving through retirement income plans to which funds are permanently committed. Even with favorable tax treatment, I do not look for dramatic results.

The combined efforts of plan salesmen, trade associations, and financial advisers will be needed to guide a tremendous number of individuals through the intricacies of the Internal Revenue Code. Because of the educational period required, it is essential that action be taken as soon as possible to enact H.R. 10.

The task of introducing even a half-million individuals a year to self-employed retirement plans is a tremendous undertaking. Its achievement could double the annual rate of growth in coverage, when employees of the self-employed are taken into account.

If this Congress will equalize incentives by passing H.R. 10, there will be good reason for the organizations which support this legislation through the American Thrift Assembly to mount a strong effort to induce widespread participation by their members.

I can conceive of no other step which would contribute more effectively to the extension of coverage.

In closing, I should like to present for the record this partial list of the organizations which wish to be specifically recorded in favor of H.R. 10. I also wish to thank the committee for the opportunity to speak on this subject of such great importance to the well-being of our fellow citizens.

Thank you, Mr. Chairman.

Senator RANDOLPH. Thank you, Dr. Murray.

PARTIAL LIST OF ASSOCIATIONS ENDORSING H.R. 10 IN THE 89TH CONGRESS

Contracting Plasterers' & Lathers International Association.
The American College of Radiology.
Society of American Florists.
American Dental Association.
Association of Consulting Management Engineers, Inc.
The Authors League of America, Inc.
American Podiatry Association.
American Society of Landscape Architects.
American Association of Medical Clinics.
American Optometric Association.
National Wholesale Furniture Salesmen's Association.
American Bar Association.
American Hotel & Motel Associations.
National Association of Women Lawyers.
American Medical Association.
National Livestock Tax Committee.
American Veterinary Medical Association.
Society of Magazine Writers.

National Society of Professional Engineers.
American Society of Industrial Designers—Industrial Designers Institute.
National Council of Dance Teachers Organization.
National Society of Public Accountants.
American Chiropractic Association.
National Milk Producers Federation.
National Association of Retail Grocer's of the United States.
Bureau of Salesmen's National Association.
Painting and Decorating Contractors of America.

Senator RANDOLPH. Mr. Norman, I suggest that you ask some questions.

We have been thinking of certain portions of your testimony. I want to have Mr. Norman proceed at this time.

Mr. NORMAN. Dr. Murray, as you know by possibly having read the report of the President's Committee, there are certain estimates of revenue loss in the report. For example, I am reading from table 5 in appendix A of the report, at which the statement is made that the net revenue loss based on the corporate income tax is $3,350 million.

Do you believe this is a justified revenue loss, in view of the retirement incomes which it makes possible for the senior citizens of our Nation?

Dr. MURRAY. Fortunately, Mr. Norman, I do not have to justify the validity as a matter of public policy of our existing pension structure in relation to this size so-called net revenue loss.

That figure of $3,350 million is a totally misleading and meaningless figure. This is arrived at by the assumption gratuitously made by the Treasury Department, and in a world of complete unreality, in which they seem to live at times, that if corporations did not make pension contributions, they would not have to make this up to their employees in the form of current compensation.

You and I know that in the negotiation of terms of employment, whether on a person-to-person basis or through the collective bargaining process, what is negotiated is the total compensation of the employee.

He may prefer to have a portion of this compensation paid in the form of pension benefits after retirement, he may prefer other portions in other forms, but compensation he will obtain.

And to think that if by magic companies were relieved of their pension contribution to present private plans, this sum would automatically fall into corporate profits is to display a strange conception of the wage determination process.

The revenue loss, so-called, is represented by two factors, the waiver of current taxation to the employee of the benefits being accrued on his behalf, plus the waiver of tax on investments making up the pension fund portfolios.

This totals nothing like $3,350 million, but something more like a billion and a quarter dollars.

Mr. NORMAN. Then your conclusion is that that is probably a somewhat inflated estimate, and that the revenue loss, if it is proper to consider it as a revenue loss, is well worth the benefits private pensions provide to the senior citizens of this country, and to business generally?

Dr. MURRAY. Without any question.

Mr. NORMAN. I would like to point out that the President's Committee report estimated that in 1980 the benefits payment would increase to about $9 billion annually. Would you, as an economist and one who has had a wide background in investments, consider it a good investment to put out $3½ billion a year, approximately, as a means of stimulating the payment in the future of $9 billion a year of retirement incomes?

Dr. MURRAY. It certainly makes good sense from the standpoint of public policy, because if our elderly have these sources of income, they will not have to be on some form of old-age assistance or supplementary income provided out of the Federal budget.

Mr. NORMAN. Thank you very much, sir.

Senator RANDOLPH. Thank you very much, Dr. Murray. Your testimony will be of benefit in view of your background and your creative thinking in this field.

Thank you, sir.

(The following letter was subsequently received from Dr. Murray in response to a question presented to him after the hearing.)

GRADUATE SCHOOL OF BUSINESS,
COLUMBIA UNIVERSITY,
New York, N.Y., April 14, 1965.

Hon. JENNINGS RANDOLPH,
U.S. Senate,
Washington, D.C.

DEAR SENATOR RANDOLPH: This is in response to a question which has been presented to me regarding the estimated decrease in Government revenue or tax deferral resulting from enactment by Congress of amendments to the Self-Employed Individuals Tax Retirement Act of 1962 which I advocated in behalf of the American Thrift Assembly when I appeared before your subcommittee on March 4.

I understand that the Treasury has estimated that the present law will reduce current income tax revenues by $180 million a year and that the elimination of the 50-percent provision would increase this figure to about $300 million a year. In the light of known experience with the development of savings and retirement programs, these estimates appear to be unreasonably high. They imply contributions under the 1962 act to retirement plans at the rate of $1 billion a year. It is inconceivable that any such volume could be generated within several years. It takes a long time to develop the plans and the mechanics of handling such funds and it takes even longer to reach the hundreds of thousands of individuals who would have to be educated about the plans and their terms.

Even if the amendments to the act were made effective this year, it is very doubtful that a flow of contributions in the range of $200 million could be developed. If achieved, this volume of contributions would imply a reduction in current tax revenues of about $60 million. Actually, even these more modest estimates appear high in the light of the experience of other programs. For example, an original estimate of $140 million by Treasury experts in Canada for a program somewhat comparable to the H.R. 10 program turned out to be $7 million.

The substantial difference in these estimates is accounted for by the failure of the Treasury Department to take into account the time and promotion effort required to launch any new and different type of savings program. The views which I have expressed reflect my own analysis of the behavior of people and their saving habits as well as studies which have been made by others. In summary, it is my belief that the sums involved in the proposed amendments to the H.R. 10 program would involve less than $50 million of revenue in either of the next 2 fiscal years. Beyond that time the amounts will depend upon the effectiveness of individuals and organizations in selling insurance and other plans to the self-employed.

Sincerely,

ROGER F. MURRAY.

Senator RANDOLPH. We have the privilege now of hearing Shelton Clarke.

Mr. Clarke.

STATEMENT OF SHELTON CLARKE, PENSION SPECIALIST, HOME LIFE INSURANCE CO. OF NEW YORK

Senator RANDOLPH. Mr. Clarke, I have read your statement earlier this morning. It is not a long one. You can read it, if you care to, or we might consider it as read and have you comment.

Mr. CLARKE. If it meets with your approval, Senator Randolph, I would like to scan read it, and comment extemporaneously.

Senator RANDOLPH. Yes, indeed.

Mr. CLARKE. First I would like to thank the committee for allowing me to testify. It is an honor.

The testimony I will offer is not based on the theory of private plans, but rather upon solid experience in the field in the design, sale, installation, and service of private pension and profitsharing plans.

Indeed, Senator Randolph, if my short statement could possibly have a title, it might be "The Facts of Pension Life on the Firing Line."

I think possibly too little today has been said that before any corporation or any employer or any self-employed individual adopts either a 401 plan, under the Corporate Code, or under H.R. 10, some individual must motivate them to voluntarily adopt these plans. The problem is essentially one of high-level salesmanship.

This morning I will be commenting on the restrictive measures now being promulgated by Treasury on both corporate pension law, and especially H.R. 10, and the effect that these measures will have, most assuredly, on the small and medium corporation and on the 8 to 10 million self-employed.

My work of course has involved me directly many times with officials of the Internal Revenue Service. Without exception, I have never failed to be impressed with the fairmindedness and the cooperative attitude of the agents of the Service, and indeed most of us in the field regard section 401 of the code as eminently fair to the taxpayer.

In recent years, however, we have noticed signs of a subtle change in attitude on the part of the Treasury Department regarding pension and profit-sharing plans.

Repeated attempts have been made by Treasury to limit the amounts of pension allocation to owner-managers, attempts have been made to liberalize vesting, to change the rate of tax on pension benefits to rates higher than the present long-term capital gains rate, and to shorten the waiting period presently allowed by Revenue Service practice.

Up to and including the enactment date of H.R. 10, and indeed down to the present time, these attempts by Treasury have been defeated, in large part by the elected representatives of the Congress.

I think our own beloved Senator Byrd was instrumental 3 years ago in keeping apart H.R. 10 from the corporate section of pension law. Much chaos would have resulted had they been combined at that time.

It is most important to note that in the considered opinion of those men whose business it is to create and install qualified retirement plans, these attempts, if successful, will severely curtail the numbers of pension and profit-sharing plans yet unborn.

Some 50 percent of our work force is yet uncovered by private plans. Just as important, in our opinion, many plans already in force will be, of necessity, abandoned, because of sharply increased costs to the employer.

Here, Mr. Norman, I am thinking of the medium and small corporation. I think today too little has been said with regard to just where these 50 percent of our work force are located.

Many of us believe that in the giant corporations, corporations deemed by the Department of Labor as large corporations, corporations with negotiated plans, our labor force is almost fully in pension and profit-sharing plans at present.

We believe that the great vacuum existing in pension and profit-sharing plan membership is in the medium and small corporation, and of course the eight to 10 million people in the self-employed occupations.

Those of us familiar with corporate pension law had been looking forward for many years to the enactment of a law granting pension plans with comparable tax relief to the self-employed. The self-employed, that is, sole proprietors and partners, represent some 9 million persons, or maybe somewhere in the neighborhood of between 8 to 10.

These men have no way in which to tax shelter income, and we know that many of them have little left after payment of living expenses and taxes. These men desperately need and deserve a retirement plan which has comparable tax relief to that of corporate employers and employees.

Of even greater significance, however, are the employees of the self-employed. These millions of persons will remain without a plan until a way is found under which their self-employed employer can be covered.

I think we have precedent in Britain and Canada in which those two countries, Mr. Norman, as I am sure you know, in their equivalent of our H.R. 10 and as Mr. Bernstein commented today, the employees are allowed to make tax deductible contributions to their plans.

This, incidentally, and the statement Mr. Bernstein made, should be examined very closely, because in that area might lie the relief for many of the destitute and indigent aged we will have in this country.

H.R. 10, as it stands today, is not a satisfactory solution to the problem.

First of all, the provisions of H.R. 10 bear little resemblance to the corporate code section 401, under which corporate plans are run.

It is obvious, when reading the law, that most of the restrictive measures long desired by Treasury for corporate pension law have indeed become law for the self-employed.

A short waiting period—3 years—is presently required, immediate full vesting for employee benefits is required, a completely new contribution concept with a $2,500 maximum is required, for the first time the tax deduction for the self-employed is but 50 percent of the contribution itself, benefits at retirement are taxed at rates higher than long-term capital gains rates, and lastly, estate tax immunity of the death benefit is denied.

All the above is in conflict with the law and philosophy of corporate section 401. Needless to say, the self-employed have not received comparable tax relief with their corporate brother.

Senator RANDOLPH. I think that is true. That is my conviction.

Mr. CLARKE. Yes, sir.

It can be proven with little difficulty that H.R. 10 as it now stands is a desirable device for only the high income, high tax bracket proprietor and partner.

It has not been bought—I am speaking of H.R. 10—and will not be bought by the medium- and low-income proprietor and partner in large numbers until certain provisions are eliminated.

I am speaking specifically of the $2,500 limit on contributions, and also the 50-percent limitation on the deductibility of contributions.

The statement, Senator Randolph, that your lawyer told you, as positive as it was, is still an understatement. That provision must come out of H.R. 10 before the intent of Congress can be realized, and that is that these 8 to 10 million people will be brought into a plan.

Senator RANDOLPH. Mr. Clarke, I have not mentioned the name of the individual, but since we have pursued this further, it is certainly appropriate to say that the statement was made by David Bress. He is a former officer of the District of Columbia Bar Association, and one of the leading attorneys of this area.

He made the statement in such a way that I realized that he felt that the intent of the Congress in the passage of H.R. 10 had not been realized.

Mr. CLARKE. It certainly has not.

It is my understanding that Representative Eugene Keogh has introduced a bill in the House of Representatives in effect redesigning H.R. 10, and specifically eliminating the above two provisions.

It is fervently hoped that his bill will become law.

Once H.R. 10 is brought into harmony with existing corporate pension law and practice, the intent of Congress will be realized.

The assumption here is that Congress intended for these people to be brought into some plan.

For, then, the millions of self-employed Americans who do not make large incomes will be able to create plans.

Our great Chief Executive, President Johnson, has appeared on television at least three times to my knowledge, at which times he has extolled the virtues of private retirement plans as an example of free enterprise at its finest.

He has asked the question that in what other country may free men share in their companies' profits, and that where else than in our great land may men look forward to a respectable old age through the payments from a private voluntary retirement plan installed by their company.

Is discouraging and restrictive legislation toward private pension and profit sharing plans in harmony with these words spoken by our President?

We think not.

I would specifically like to read into the record, if I may, in conclusion, Senator Randolph, this statement: Very many of the persons yet uncovered are in the corporations not unionized.

This is true, and I think statistically, Mr. Norman, you should probably be aware that the vast bulk of unionized companies have almost 100 percent of their employees already in adequate pension and profit-sharing plans, promising them under 401 of the code a subsistence level at retirement which, when put together with social security, will at least be 50 percent of their salary.

In the pension and profit-sharing field, we feel that 50 percent of pay is an adequate plan.

Eight million more of these men are self-employed. Crippling or restrictive legislation will only increase the cost of these large, gigantic plans, because they will bear this increased cost without too much trouble. It will be passed on to the consumer who buys their product. It might be inflationary, but it will not cause these plans to be abandoned.

But restrictive legislation will sharply curtail the numbers of yet unborn plans in the medium and small corporations, and it will cause abandonment in very many of the small plans.

Senator RANDOLPH. Thank you, Mr. Clarke.

I believe, Mr. Norman, you had a question.

Mr. NORMAN. Mr. Clarke, am I to gather from your statement that you believe that if the present H.R. 10 would remove the restrictions on the previously enacted H.R. 10, if this new bill were enacted, you believe that the insurance industry, that is, people like yourself, could probably solve a great deal of the problem of extending private pension plan coverage to these smaller employer units? Is that a correct interpretation of your statement, that your people would be able to get out and convince these people to obtain coverage?

Mr. CLARKE. Mr. Norman, may I mention very quickly the people today who are in the business of putting H.R. 10 plans on the books? The smallest force of employees aggressive in this field are in the banks, the trust departments. Consulting actuaries, regard these plans as probably too small to think about, and they are probably not doing anything.

The securities salesmen, men who sell mutual funds and securities, are very aggressive in this field, and the insurance industry, which you specifically asked me about, probably has the largest field force who will attempt to acquire H.R. 10.

I think all of these men will probably agree with the question you asked, and that is if these two provisions are eliminated, a great many self-employed, partnerships, and proprietorships will adopt H.R. 10.

Those two provisions are the two big deterrents.

Mr. NORMAN. There are representatives of the insurance industry in about every town and hamlet in this Nation. Do you believe that all these insurance agents would be interested in this type of business, and convincing employers of the desirability of adopting H.R. 10 plans?

Mr. CLARKE. I do not think there is any doubt about it, Mr. Norman. Yes.

The finest sales force on earth today is probably the life insurance industry, and I think these men would have a great deal to do with bringing large numbers of these people into H.R. 10, if they had something to work with, which they do not, as yet.

Mr. NORMAN. Thank you.

Senator RANDOLPH. Thank you, Mr. Clarke. Our next witness is Prof. Carl H. Fischer. You may proceed, Professor.

STATEMENT OF PROF. CARL H. FISCHER, PROFESSOR OF INSURANCE AND ACTUARIAL MATHEMATICS, UNIVERSITY OF MICHIGAN

Dr. Fischer. My name is Carl H. Fischer. I am professor of insurance and actuarial mathematics in the University of Michigan, where I have been a member of the faculty since 1941.

I received a Ph. D. in mathematics at the State University of Iowa in 1932. I am a fellow of the Society of Actuaries, an associate of the Institute of Actuaries of Great Britain, an associate of the Conference of Actuaries in Public Practice, and a member of the Fraternal Actuarial Association.

In 1957–58 I was a member of the Advisory Council on Social Security Financing.

In 1960–61 I was the chairman of the Study Committee of the University of Michigan, which reported to the Committee on Armed Services of the U.S. Senate on the assigned topic: "A Study of the Military Retired Pay System and Certain Related Subjects." This report was published by the Committee on Armed Services on July 6, 1961, and printed by the U.S. Government Printing Office.

I have been a consultant on pensions and social security to the Republic of the Philippines in 1956 and 1962. Is the first case I submitted reports to the ICA, now AID, offices in Manila and Washington and to the Philippine systems. A summary of one of the reports was published in the Journal of Insurance (vol. 24, 1958) under the title "Social Security in the Philippines."

I have also served the States of Michigan, Indiana, and North Dakota, several municipalities, and a number of corporations as an actuarial consultant on pensions.

I have been teaching a graduate course in pensions ever since 1947. I am the joint author of three textbooks, and have published over 30 articles on mathematics, statistics, demography, insurance, and pensions.

In this statement I will follow the order and numbering of the "Questions to be Answered at Hearings on 'Extending Private Pension Plan Coverage'."

In answer to questions 1 and 2:

> 1. Is it a wise and proper activity of the Federal Government to encourage the extension of private pension coverage to more of its citizens and to seek to increase the amount of private pension income received in retirement?
>
> 2. What advantage do private pensions offer from the standpoint of the employee? The employer? The Federal Government?

I believe that it is indeed "a wise and proper activity of the Federal Government to encourage the extension of private pension coverage to more of its citizens, and to seek to increase the amount of private pension income received in retirement."

Private pension plans offer an opportunity for free men acting voluntarily to find a solution to the economic problem of the aged. Private plans can be geared to the particular situation of the locality and of the individual employer and the employees, offering flexible solutions.

Many economists look upon pensions as deferred wages, and these, like all wages, should be set by mutual agreement, rather than compulsion.

3. What is the annual loss resulting from the present favored tax status of private pensions?

There is no doubt that the Federal law permitting contributions to pension plans to be deducted from income, as an ordinary and reasonable business expense, for tax purposes, has aided materially in the rapid expansion of pension plans in the United States.

It should be pointed out, however, that, although there is an immediate reduction in corporate and personal income taxes because of this law, this reduction does not represent a total loss to the Government, but, to a considerable extent, merely a postponement.

This may be seen if we note that in the long run the true cost of a pension plan consists simply of the actual payments made to the beneficiaries plus the administrative expenses, which are usually minor.

The method of funding the plan can make a difference in the timing of the actual outlays by the employer, and interest earned on investments can have some effect on the size of the outlays, but none of this affect the payments to the pensioners, which depends, of course entirely upon the benefit formula.

In the long run, no matter how you fund the plan, the true cost will be the same.

Thus, for any given plan, if the employer were to pay out the pensions each month directly to the pensioners, a pay-as-you-go system, as some people do, he will actually have a larger total outlay in the long run than he would if he were to make contributions to a trustee or insurance company and build up a fund which would earn interest and help reduce his future outlays.

Thus the total outlays and tax deductibility would be larger in the pay-as-you-go case than in the advance funding case, yet it is in the case of the latter that we feel there is a tax loss. This is merely a postponement.

On the other hand, it is undoubtedly true that the Revenue Code gives a real concession to the participants in a pension plan. The contributions of the employer are not considered as income to them at the time they are made, and hence are not taxed then. When the pension payments are eventually received, the income is fully taxable, but by then the individuals will generally be in a lower tax bracket, and, in addition, may be able to take advantage of a larger personal exemption granted older persons.

Thus, there will be some tax loss due to pension plans, but the principal effect is that of tax postponement.

4. Is the revenue loss more in the nature of a "tax loophole" which permits some to avoid paying their fair share of taxes, or is it more in the nature of a sound investment in the future retirement incomes of our senior citizens and in the future economic stability and prosperity of Americans of all ages?

5. To what extent is the revenue loss offset by decreased Federal expenditures such as those for public assistance?

If we agree that pensions are a legitimate expense of business, just as are wages, this temporary "revenue loss" could not be termed a "tax loophole."

Further, whatever one's views are about the magnitude of this revenue loss, it is certainly "in the nature of a sound investment in the future retirement incomes of our senior citizens and in the future economic stability" of our country.

Undoubtedly the existence of private pension plans causes lower Federal expenditures for public assistance than would otherwise be the case. To answer this question statistically would require a comprehensive study of considerable magnitude.

6. It was estimated in the report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs that approximately 50 percent of the nonagricultural work force is not covered by private pension plans. Who are the workers who are not covered?

It is generally recognized that most large- and medium-sized firms have installed pension plans for their workers, often on a union-negotiated basis.

Further, many small employers in certain industries, notably the construction industry, are members of multiemployer pension plans negotiated by agreement between a labor union and the employers' association.

The workers not covered by pension plans are apt to be found in the employ of small corporations and of partnerships and individual proprietorships in industries not covered by multiemployer plans.

There is a reason for this. The administrative expenses of operating a pension plan, usually not high per employee in a big plan, may become disproportionatly high in a small-scale plan.

Fixed minimum charges may make a deposit administration plan or a trusteed plan too high. The group may be too small to get the proper spread of risk, so that the employer is practically forced into an individual policy plan which, while eminently satisfactory in many respects, does have a higher unit cost.

There is another point, here, that the employer himself cannot get it. I cover that later.

8. What Federal statutes, regulations, and administrative actions and policies would contribute to the extension of private pension coverage at reasonable Federal costs?

The pension coverage in this country has grown at a tremendous rate since the war. This growth continues. When anything is as successful as this, it seems prudent to go about changes with great care.

Perhaps the best course for the Congress would be to avoid making any serious legislative changes regarding pension plans, particularly changes which are restrictive. Three proposals along these latter lines have been put forth by the President's Committee on Corporate Pension Plans.

(*a*) The proposal to regulate funding. There are a number of actuarially accepted methods of funding a pension plan, and these produce different levels of current service liabilities and of accrued liabilities. The use of different actuarial assumptions as to interest, mortality, turnover, salary increases, age at retirement, and so forth, can also materially affect the calculations.

If an equitable and effective law were to be passed to regulate funding, it would have to specify the actuarial methods and assumptions to be used for all plans. This would indeed put pension plans in a straitjacket.

Further, pension plan benefits seem to be in a constant state of flux, caused at least partially by the continuous erosion of the value of the dollar. Each time that benefits are raised, not only are the current service liabilities raised, but also the accrued liabilities. The employer is always on the funding treadmill, never being able to catch up.

This does not seem to cause great concern on the part of the labor leaders, who seem content to negotiate for increased benefits, and to let the funding slide back to a lower level at each time there is an increase.

As long as we deal with a continuing entity, the level of funding is probably not of great importance. Indeed, the various governmental pension plans seem to rely on this principle completely. Social security, civil service, and railroad retirement pension plans are all seriously underfunded, but little attention is paid to this.

The military retirement is entirely on a pay-as-you-go basis, with absolutely no advance funding whatever.

However, funding is of vital importance in the event of the termination of a plan. Sometimes workers are left without receiving in full the pensions they had expected. This is unfortunate, but is of fairly rare occurrence, and in some cases not as bad as it seems at first sight.

Plans terminating in such a condition are almost always plans of fairly recent origin, which had not had enough time to build up a sizable reserve fund. Just a short time ago these employees had had no pension plan at all. They had not anticipated any pension. When the plan was installed, they received credit for service rendered in the past during years when they had not been expecting any pension credits. Now, in spite of the termination, they receive something.

In other words, they are at least better off than they had originally expected to be. Perhaps if heavy funding had been a prerequisite to starting a plan, their employer would not have had a plan at all. Would this have put the employees in a better position? Union leaders have often realistically agreed that some kind of plan is better than no plan.

(*b*) The proposal for early vesting: I am in favor of reasonably early vesting in the form of a deferred pension, with payments to begin at normal retirement age, but I do not believe it is necessary to compel this by law. The trend is now and has been for some time in this direction.

It seems better to have a pension plan without vesting than to have no plan at all. The automobile workers took this attitude, started with no vesting whatever, and now have succeeded in having strong vesting added to their pension plans.

(*c*) The proposal to establish compulsory "reinsurance": The President's Committee raised several questions in this regard, but the first is the major one: is the possibility of a plan's termination an insurable risk? If the answer is "no," as I believe, then there is no point in raising further questions. This type of "insurance" is like flood insurance. Only the property in the river bottom lands is in danger, and hence, if the insurance is on a voluntary basis, no one else will subscribe. The resulting premium would be too high to make the insurance practicable.

Government could, of course, force soundly financed plans to contribute to the weaker plans, thus encouraging reckless investment and minimum contributions on their part, while penalizing the thrift and good management of the better plans. This seems grossly inequitable and contrary to sound public policy.

10. To what extent has advantage been taken of the Self-Employed Individuals Tax Retirement Act of 1962 (H.R. 10) in extending private pension coverage?

13. What amendments to that act would make it a more effective stimulant to extension of private pension coverage?

One factor which has had an effect on pension coverage of small firms is the natural wish of the proprietor or partners to participate in the advantages of pensions, just as do the officers in a corporation. However, they were entirely excluded until the passage of the Self-Employed Individuals Tax Retirement Act of 1962—H.R. 10.

This act has helped somewhat, but its present shortcomings have limited the utilization of its provisions. The major drawback is that only one-half of the contributions toward the self-employed individual's pension is considered a tax-deductible expense.

Hand in hand with this goes the requirement that the owner-employer must provide vested pensions for all of his employees. This is probably a very good idea, and if the provisions for the proprietor's own pension were relaxed so that he might be in nearly as favorable position as the head of a corporation, we might find a good many more employees in very small firms being brought into private pension coverage along with the proprietor himself.

Thus, one important step which the Congress might take to encourage the extension of pension coverage would be to amend H.R. 10 to provide for the full deduction of the contributions made toward the funding of pensions for the self-employed.

15. What would be the effect upon extent of private pension plan coverage of the recommendation of the President's Committee that the option which qualified retirement plans now have to cover only salaried or clerical employees be eliminated, unless there is a showing of special circumstances?

The present Revenue Code specifically states that it shall not be considered discriminatory to cover only salaried or clerical employees. However, it is my understanding that the Internal Revenue Service, at least in some of its district offices, now refuses to qualify a proposed pension plan for salaried employees only unless the employer has in effect or is simultaneously proposing a pension plan for hourly employees also.

If this is the current practice, then it would appear that a change in the code eliminating plans for salaried employees only would merely legitimize the present practice.

While I am strongly in favor of pension plans for all employees, I am not sure that it would be advantageous to eliminate the possibility of an employer starting out with a plan for salaried employees only.

It can be argued that an employer is more likely to start a pension plan for his salaried people because he feels that they are the ones on whom the success of the business depends, and that it is much cheaper to cover only this limited number of people. Certainly that is the way that thousands of firms got into pension plans in the first place. Now most of them have extended coverage to their hourly employees.

Thus, to permit salaried-only plans might be, as it has been in the past, a good way of getting hourly employees covered by pensions.

16. What would be the effect on extension of coverage of that committee's recommendation that the maximum period for which coverage of any employee can be deferred by qualified plans be reduced from 5 to 3 years?

I do not think that lowering the maximum period during which coverage of an employee may be deferred from the present provision of 5 years down to 3 years would have any important effect.

In the first place, few plans of any size have a period of deferment as long as 5 years. In fact, many if not most have a year or less. In the case of trusteed or deposit administration plans, there is little incentive to have a long deferred period.

Under many benefit formulas, the ultimate pension to be paid would be the same in any case, so that the longer the period of deferment, the shorter would be the time during which the employer could build up the required fund for the employee.

The real purpose behind the deferment is to save on administrative costs in setting up pension records for employees who prove to be temporary and then having to go to the trouble of canceling them. The provision is used mainly in small plans insured under individual policies where there is an appreciable surrender charge when the policies are issued and then canceled.

This, of course, makes this fairly expensive type of plan to begin with more expensive for the small employer. I cannot see that any social purpose would be served by penalizing these small plans still further by forcing them into additional unnecessary costs in surrendering policies.

SUMMARY

The private pension system in the United States is in a healthy, rapidly growing condition. Care should be exercised not to interfere with this sound growth, particularly through restrictive legislation.

To assist in extending pension plan coverage to the groups of citizens needing it most, the employees of small firms, mostly partnerships and sole proprietorships, the provisions of H.R. 10 should be amended to allow full tax deduction for the contributions made toward the pension of the self-employed owners.

This would encourage such owner-employers to establish plans for themselves and their employees.

Some other restrictions might be relaxed, but the major difficulty is the partial deductibility.

And I might also say that this morning a suggestion was made which I think also sounds very good to me, and that is having the contribution made by employees toward a contributory plan made tax deductible, as it is in Canada, for example.

At the present time, the fact that the contribution of an employee to a pension plan, the money he pays is first taxed and then he pays into the plan, is the principal reason I think the contributory plans are definitely on the wane.

Senator RANDOLPH. Professor Fischer, we are grateful for your testimony.

I particularly noted that you have indicated that the present pension plan coverage is essentially sound, and you use the word "healthy." Does this mean to you that the Congress must be very careful about any restrictive legislation?

Now, I understand what you have said, but you have indicated there is one area where an amendment to H.R. 10 is advisable. Are there any other areas in which you think this subcommittee might check the matter out, as it were?

As chairman of the subcommittee, I would be very careful in this field. I would not want to do violence in any way to the private pension plan coverage. I am wondering if there is a challenge, however, to this subcommittee to move very carefully in some of these matters beyond H.R. 10 that you mentioned.

Dr. FISCHER. Yes. There is one additional idea that I have had, and that is the Internal Revenue, of course rightly watches the tax collection very carefully. They are extremely careful not to let a plan become overfunded, and if a contribution is made when a plan is overfunded, a tax deduction is not permitted on that.

In other words, a company can fund up to or nearly up to the full amount that their funding method calls for. Now, insurance companies do not operate that way. Insurance companies are permitted, and in fact required, to have a surplus to allow for contingencies.

It seems to me an amendment permitting a small surplus, say 5 percent, for example, might not be amiss. I think that is worthy of further study.

Senator RANDOLPH. Thank you very much, Professor Fischer. We are grateful for your testimony.

Dr. FISCHER. Thank you. It is a great opportunity to be here.

Senator RANDOLPH. Would it be convenient, Mr. Dickson, for you to appear at this time instead of this afternoon, as you were scheduled?

Will you identify those persons who accompany you, Mr. Dickson?

STATEMENT OF WILLIAM P. DICKSON, ESQ., ATTORNEY AT LAW, NORFOLK, VA., CHAIRMAN, SPECIAL COMMITTEE ON RETIREMENT BENEFITS LEGISLATION, AMERICAN BAR ASSOCIATION; ACCOMPANIED BY DONALD E. CHANNELL, DIRECTOR, WASHINGTON OFFICE, AMERICAN BAR ASSOCIATION; AND CHARLES M. NISEN, ATTORNEY AT LAW, CHICAGO, ILL.

Mr. DICKSON. I shall.

Senator RANDOLPH. And will you identify yourself, please?

Mr. DICKSON. I am William P. Dickson, Jr., from Norfolk, Va., a general practitioner of law.

I have with me Mr. Donald E. Channell, the director of the Washington office of the American Bar Association, and Mr. Charles M. Nisen, practicing attorney in Chicago, who was a principal author of the American Bar Association's retirement plan.

In perfect candor, I am a very general practitioner. I am an expert in no field. I have never written any book.

I thought it better be understood I was not an expert following so many.

I am surprised to be here, in that as the chairman of the Retirement Benefits Legislation Committee of the American Bar Association, President Powell surrounded me with experts, including a former Commissioner of Revenue, my old schoolmate, Mr. Morty Caplin, and Mr. Leslie Rapp, of New York, a former counsel of the House Ways and Means Committee.

One went to Turkey, and the other is involved in a tax case, so I came to plead our cause.

I would like to make a few general remarks before giving my prepared statement.

I have been in practice for 27 years, and understand a great deal more now about the retirement plans than ever I had considered before. Having started with no fixed income whatsoever back in depression days, and having managed to come up to a modest income some 27 years later, I have gotten to that stage in life when I can hardly look my life insurance friends in the face, having been convinced that a large life insurance program would provide a retirement for myself, if I ever got old enough, or provide some benefit for my wife and children should I depart earlier than expected.

But the inflation of the dollar has put that in a poor position.

Along with thousands of lawyers, I am convinced that we should have retirement plans, and that H.R. 10, if it had been passed as originally conceived some 10 years ago, would have been a splendid victory.

The remarks I will make today will be addressed to retirement for the self-employed, particularly lawyers, and what can be done in the immediate future to bring private retirement plans to 20 million people not presently covered.

The American Bar Association has for many years been interested in bringing about an improvement of our tax laws to provide an opportunity for self-employed individuals and their employees to participate in tax-deferred retirement plans.

Many State and local bar associations have also been interested in this problem, but in the interest of your time, we have not encouraged them to send witnesses to this hearing.

Although not representative of other self-employed groups and professions, I am well aware of the fact that many groups of such persons throughout the country are vitally interested in the same problem and that, together with the American Bar Association, self-employed individuals, both professional and otherwise, and their employees, number approximately 20 million persons.

In any consideration of the matter, there is one basic fact to be borne in mind, namely, that corporate employers and employees have been beneficiaries of retirement plans under statutory laws excluding the self-employed.

In 1942, our tax laws were changed to offer substantial tax benefits to corporations and their employees in the establishment of pension plans, supplementing social security. The tax effects of these plans are:

First, the contributions by the employer for the employee, although in the nature of additional compensation, are not taxable to the employee until the retirement benefits are received in later years.

Second, the employer gets a tax deduction for the contributions when made.

Third, the earnings from the retirement fund are tax exempt until distributed.

Fourth, the retirement benefits are distributed at a time when the employee would normally be in a lower tax bracket.

There has been a tremendous growth of such plans over the past 20 years. Today, approximately 25 million persons are covered by private retirement plans. However, almost none of these plans is for the self-employed individuals and their employees.

Without some tax deferral for retirement savings, adequate saving for old age by the self-employed is virtually impossible, one of the prime reasons being the high income tax rates in effect.

The practicing lawyer, for example, has a peak earning period of 20 years, generally thought to be between 45 and 65 years of age. He must, in those years, put aside enough to take care of his old age. The result often is that, after he pays his taxes and suffers the high cost of living, the opportunity to provide for his old age is virtually nonexistent.

Certainly, we lawyers would much prefer to have an opportunity to help ourselves, rather than be helped by the Government or charity in our old age.

I might remark that in my conversations with lawyers who go to the law schools to hire young men to come into their firms, they find that men in their middle twenties are concerned about their old age. We find an increasing tendency on the part of these young men to go to corporations that offer benefits such as retirement plans, profit sharing, pensions, and so forth, rather than go out into the active practice of law, into the forum, where only the opportunity exists, but with none of the benefits.

The result of the legislation enacted in 1942 was to discriminate in favor of employed persons and against all self-employed persons and their employees.

To correct this obvious inequity, the American Bar Association and many other organizations representing self-employed persons sought legislation which would secure a measure of equality with corporate officers and employees in respect to the tax treatment of earnings set aside for retirement purposes.

Finally, in 1962, the Smathers-Keogh bill—H.R. 10—was passed by Congress, and for the first time recognition was given to the problem of the self-employed in this important field.

Although the Self-Employed Individuals Tax Retirement Act of 1962 was a step forward, it by no means provides an adequate method for average self-employed individuals to establish retirement plans.

Over the long legislative history of H.R. 10, the effect of the legislation was weakened considerably, and in the final days of the 87th Congress, an amendment was added on the Senate floor to H.R. 10 which substantially diminished the intended value of the legislation.

Although there are several defects in the 1962 act, the American Bar Association is supporting legislation—H.R. 10—introduced in the present Congress by Representative Eugene Keogh which seeks to make only two major improvements designed to permit self-employed individuals and their employees to more equitably provide for their own retirement.

The first such improvement proposed by the new H.R. 10 would permit the self-employed person to deduct the entire amount of the contribution made in his behalf to a retirement plan. Under the 1962 act, as a result of the floor amendment, the self-employed individual is limited to a 50-percent deduction of his contribution on his behalf in a noncontributory plan. This limitation is even more severe in a contributory plan, and results in possibly a deduction of only 25 percent.

Such a limitation never was proposed by the Treasury Department or by either the Senate Finance Committee or the Ways and Means Committee of the House in its long consideration of the legislation. Removal of the 50-percent limitation would help a great deal in encouraging self-employed individuals to participate in plans and to provide coverage for their employees.

The second provision proposed in the new H.R. 10 would be to eliminate the dollar ceiling on deductible contributions that could be placed in such plans, provided, of course, that employees are covered.

In order for such plans to qualify, they must be nondiscriminatory as between the contributions made by the self-employed for himself and for his employees. With such a requirement, and the fact that employees must be given fully vested rights, we do not feel that a dollar limitation is necessary.

I submit for the record an excerpt from an excellent article which appeared in the Tax Law Review of New York University School of Law in March 1963, describing the two most glaring defects in the present act and the reasons for their correction. This article was written by the chairman of the advisory committee of the special committee on retirement benefits legislation, Leslie M. Rapp.

Excerpt From the March 1963 Tax Law Review of New York University School of Law

Although Public Law 87-792 has many imperfections, the most glaring, and therefore the most in need of correction, is that limiting the deduction of a self-employed person to only one-half the contribution to the retirement fund in his behalf, with a top limit of $1,250 per annum.

This deduction formula of 50 cents on the dollar was conceived by its sponsor, Senator Long of Louisiana, as a supposedly necessary corollary to the treatment of a self-employed individual under the act as both his own employer and his own employee. The Senator's reasoning was that an employee is not permitted a deduction for his own contribution under a plan but receives tax deferment only with respect to the contribution made in his behalf by his employer. Therefore, according to the Senator, a self-employed person, in his dual capacity as employer and employee, should be similarly treated by allowing him a deduction for only the portion of the contribution made in his capacity as employer, which he arbitrarily deems to be one-half the total contribution.[94]

There is, of course, a basic fallacy in this reasoning. In the first place, it is being applied not only to contributory pension plans but to noncontributory plans as well. Where a self-employed person establishes a noncontributory plan and contributes no greater percentage of his income for himself than for his employees, he is not making any contribution as an employee but entirely as employer. Therefore, his entire contribution should be deductible as a part of the expense of doing business, as in the case of corporate pension plans which benefit stockholder-employees.

Of course, if a self-employed person sets up a contributory plan, whereby he pays the basic cost of the plan for himself and his employees, and under the plan voluntary contributions by both the employer and the employees are permitted, the employees in that situation obtain no tax deferment or deduction with respect to their voluntary contribution. Neither, however, would the employer, since in such case he would be making the supplemental voluntary contribution in his capacity as an employee. However, where the employer pays the entire cost under the plan, no part of his contribution is made by him in his capacity as an employee.

In the case of a contributory plan under which the basic contribution of the employer is matched by voluntary supplemental contributions, Senator Long's deduction formula would operate to limit a self-employed individual's deduction to only one-quarter of his total contribution in his own behalf. This arithemetical fact demonstrates more clearly than words the fallacy underlying the Sena-

[94] Congressional Record 17676 (daily ed. Sept. 6, 1962).

tor's deduction limitation which, unfortunately, the Congress itself has allowed to be written into the law.

Senator Long has also sought to justify the deduction limit to one-half the total contribution of self-employed persons in their own behalf, on the ground that he, as a participant in the civil service retirement program, obtains no tax deferment deduction for his 6½ percent contribution to the fund but only as to the Government's 6½ percent contribution.[95] Again, this reasoning confuses contributory plans with noncontributory plans. In any case, the fact is that the civil service retirement plan is not fully funded, with the result that the Government ultimately will have to bear more than two-thirds of the total cost. Under Senator Long's theory, this should justify increasing the deduction of a self-employed person to at least two-thirds of his total contribution. It should also be noted that most corporate pension plans are noncontributory and that the trend is definitely away from those that are contributory.

A second criticism of the new law, which relates to the objection to the 50 cents on the dollar deduction limit, is the $2,500 limit on contributions for a self-employed person, at least where the self-employed person has employees in whose behalf he is making contributions under the plan which are at the same percentage rate as he makes for himself. Since employees are given fully vested rights under the act, it would appear that as long as the plan meets the normal nondiscrimination tests a self-employed individual should be permitted to participate under his plan on the same basis as his employees, with no arbitrary dollar limitation.

The Self-Employed Individuals Tax Retirement Act of 1962 is a far from perfect statute. Most certainly it will be improved upon with the passage of time. Meanwhile, it has given the self-employed a limited opportunity to establish tax-sheltered retirement funds in their own behalf, provided they also make provision for their regular employees.

While it has taken 11 years of effort on the part of the self-employed to achieve even this partial victory, it was inevitable that the discrimination against them would not be allowed to continue indefinitely. Just as the noncommunity property States began to enact community property laws to gain the same split-income advantage for their married citizens as obtained in States with civil law backgrounds, with the result that the Federal tax law was ultimately changed to give them the equivalent benefit, so professional groups of the self-employed have, through securing the enactment of State laws permitting their incorporation, demonstrated that the long-existing discrimination against them could, in a large measure at least, be corrected without Federal legislation if necessary. Because of the limited benefits conferred under Public Law 87–792, this movement may well continue until true equalization of the treatment of the self-employed and stockholder-employees of corporations has been achieved one way or another.

Mr. DICKSON. Various solutions have been considered to the problem to provide equitable treatment of the self-employed.

You know, we self-employed have long been called the pioneers of the country, or the backbone of the Nation, but under the present tax structure, it looks as though the backbone of the Nation might soon be broken.

Besides what was done in the 87th Congress and the proposed legislation under the new H.R. 10, there has been a movement, by certain groups, to take advantage of the provisions of the tax laws relating to corporations, resulting in the formation of professional corporations or associations.

It might well be said that because of the inadequacy in the 1962 act, many self-employed individuals have sought another approach to the problem by forming professional corporations or associations. Traditionally, members of the professions have practiced as self-employed individuals, and not as employees of professional corporations.

Many State laws prohibited professions such as law and medicine from practicing as corporations. Moreover, the ethics of a good many

[95] Hearings before Senate Finance Committee on H.R. 10, 87th Cong., 1st sess. 120–121 (1961).

groups in various States prohibit corporate practice by professionals. However, some 30 States have enacted laws authorizing members of the various professions to form corporations, but the Treasury Department has indicated that it would not recognize such professional associations as corporations for income tax purposes under the Internal Revenue Code, and, therefore, this avenue has been virtually closed to the professional individual.

If the Treasury Department changed its position, or if legislation were enacted to amend the code respecting professional corporations, it would bring about a substantial increase of coverage of self-employed individuals.

I should point out here, however, that if this came about, it would still not take care of the individual who wants to practice his profession as a self-employed person and who would refuse to incorporate in order to have tax benefits. It would also not take care of the professional persons who are prohibited by law or professional ethics from practicing as a member of a corporation.

I do not believe that it is sound policy for the tax laws of our country to force professional individuals to incorporate in order to provide them with an opportunity to save for their old age.

Nevertheless, the American Bar Association has a committee on this subject, and I submit with my statement a copy of recommendations adopted by the house of delegates of the American Bar Association in New Orleans in February 1965, recommending certain amendments to the Internal Revenue Code regarding professional associations and corporations.

Senator RANDOLPH. That will be included in the record.

Mr. DICKSON. Yes, sir.

(The information referred to follows:)

AMERICAN BAR ASSOCIATION

SPECIAL COMMITTEE ON PROFESSIONAL CORPORATIONS

RECOMMENDATION

The special committee on professional corporations recommends that the house of delegates adopt the following resolution:

Whereas legislation has been enacted in more than 30 of the States of the United States authorizing members of various professions to form corporations or associations for the practice of their respective professions and to become employees of such professional corporations or associations, and a large number of such corporations and associations have been so formed; and

Whereas the Treasury Department and the Internal Revenue Service have indicated they will persist in refusing to recognize, and will continue their efforts to prevent the recognition by the courts of, professional corporations and professional associations as corporations for income tax purposes under the Internal Revenue Code and the regulations issued thereunder, and pursuant to such purpose have indicated they will adopt proposed regulations which are contrary to existing law and would constitute a usurpation of legislative power; and

Whereas while the association leaves it to each lawyer whether or not to practice in corporate or association form, where authorized in his particular State, it is the position of the association that lawyers and members of other professions who adopt such form of practice are entitled to fair and reasonable and nondiscriminatory interpretation and application to them of the income tax laws and regulations; and

Whereas there have been introduced in the Congress a number of substantially identical bills to amend the Internal Revenue Code to expressly include professional corporations and associations in the definition of the term "corporation," which bills are similar in form and substance to the proposed amendments hereinafter set forth; Therefore, in furtherance of tax equality for members of the professions authorized and desiring to practice in corporate or association form, be it

Resolved, That the American Bar Association recommends to the Congress that professional corporations and professional associations formed under State law be expressly included in the definition of the term "corporation" for tax treatment under the Internal Revenue Code; and be it further

Resolved, That the Association proposes that this result be accomplished by amending section 7701(a) of the Internal Revenue Code of 1954; and be it further

Resolved, That the special committee on professional corporations is authorized and directed to urge the following amendments, or their equivalence in purpose and effect, upon the proper committees of the Congress:

SEC. 1. The following provisions of section 7701(a) of the Internal Revenue Code of 1954 (relating to definitions) are amended as follows:

(1) Paragraph (1) is amended to read as follows:

"(1) Person.—The term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, or corporation."

(2) Paragraph (3) is amended to read as follows:

"(3) Corporation.—The term 'corporation' includes associations, joint-stock companies, and insurance companies. It also includes professional corporations and professional associations formed under the law of any State, the District of Columbia, or any U.S. possession."

(3) Paragraph (7) is amended to read as follows:

"(7) Stock.—The term 'stock' includes shares in any corporation."

(4) Paragraph (8) is amended to read as follows:

"(8) Shareholder.—The term 'shareholder' includes a member of any corporation."

SEC. 2. For taxable years beginning prior to January 1, 1965, the determination as to whether a professional association or professional corporation formed under State law is to be treated as a corporation for purposes of the Internal Revenue Code shall be made as if this act had not been enacted and without inferences drawn from the fact that this act is not made applicable with respect to years before 1965.

SEC. 3. The amendments made by the first section of this act shall apply to taxable years beginning after December 31, 1964.

REPORT

In the written and oral reports of the special committee on professional corporations presented to the house of delegates at the 1964 annual meeting attention was called to certain regulations proposed by the Commissioner of Internal Revenue. These would amend current regulations pertaining to section 7701 of the Internal Revenue Code (the so-called Kintner regulations) particularly section 7701(a)(3) defining the term "corporation" as including associations, joint stock companies, and insurance companies. The evident purpose and effect of the proposal is and would be to prevent professional corporations and professional associations from being recognized as corporations for income tax purposes, thus denying them, among other tax benefits, the right to make tax deductible contributions to employee retirement plans.

At the 1963 annual meeting the house of delegates approved a recommendation of the special committee that the proposed amendment of the Kintner regulations (which amendment had at that time been announced but not yet promulgated) be studied by the tax section of the association in collaboration with the special committee on professional corporations and comments thereon consistent with the views expressed in the special committee's 1963 report be communicated to the Internal Revenue Service in writing and at any hearings which might be held to consider such amendment. In the above mentioned 1964 report the house of delegates was advised that such comments were filed, along with those of some 600 other organizations and individuals, and that representatives of the tax section and the special committee presented orally at the hearing in Washington, D.C., in March of last year the views expressed in such comments.

Despite the nationwide outpouring of objections to the proposed regulations and the extended oral hearing which reiterated such objections and emphasized the unfairness and unsupported legal basis for the proposal, the indications are that the Treasury Department and the Internal Revenue Service intend to adopt the proposed regulations substantially in the form proposed.

Such proposed discrimination between professional corporations and associations and so-called business corporations and organizations is manifestly unfair and contrary to the policy that lawyers who adopt corporate or association form of practice in those States which authorize it are entitled to fair, reasonable and nondiscriminatory interpretation and application to them of the income tax laws and regulations.

In the special committee's 1964 written report it was pointed out that various bills were then pending in the Congress to amend the definition of "corporation" in section 7701(a)(3) of the Internal Revenue Code to make it clear that that term includes professional corporations and professional associations formed under State law. Some 32 States now have statutes authorizing such organizations.

In the subsequent oral report the house of delegates was advised that the special committee had been meeting with a group of experienced tax section members, and with their assistance would study these bills with a view to arriving at a form of bill considered adequate for its intended purpose, and if arrived at, would be presented to the house of delegates at the 1965 midyear meeting with the recommendation that the proposed legislation be approved and the special committee be authorized to take appropriate action for its enactment. That study has now been completed and a form of bill has been agreed upon which is similar to those introduced in Congress and which it is believed would give statutory recognition to professional corporations and associations as corporations under the Internal Revenue Code, despite any regulation to the contrary. That agreed form of legislation is incorporated in the resolution which the special committee recommends be adopted by the house of delegates.

Draft copies of this report, including the proposed legislation and resolution, have been sent to the chairmen of the lawyers' retirement plan committee, retirement benefits legislation committee, economics of law practice committee, section of taxation, section of real property, probate and trust law, partnership committee of the section of taxation, pension and profitsharing trusts committee of the section of real property, probate and trust law, and partnerships and unincorporated business organizations committee of the section of corporation, banking, and business law.

At its meeting on June 24, 1964, the House of Delegates of the American Medical Association adopted a resolution relating to the proposed amendment of the Kintner regulations and providing for continuance of "its vigorous opposition to tax regulations that discriminate against 'professional associations' and 'professional corporations'" and "it's support of legislation which seeks to provide tax equality with business corporations for 'professional associations' and 'professional corporations'."

It is the declared policy of the American Bar Association not to take a position either for or against professional corporations and to leave it to each State to decide whether or not to authorize such corporations and to each lawyer whether or not to avail himself thereof where authorized. That policy is frustrated if lawyers who seek to avail themselves of such form of practice where authorized by State law are denied the income tax benefits of corporate form by unwarranted refusal of the Internal Revenue Service to recognize professional corporations and associations as corporations under the Internal Revenue Code and by further seeking to prevent such recognition by the promulgation of arbitrary, unfounded, and indefensible regulations. Such proposed action would be a further evidence of attempted exercise of legislative functions by an administrative body and the usurpation of the legislative power of Congress. Such conduct is contrary to the established policy of the American Bar Association relating to the functions of administrative bodies and has been condemned on other occasions by the house of delegates.

The special committee strongly recommends adoption by the house of delegates of the resolution set forth in the recommendation at the head of this report and believes that such adoption is consistent with and in furtherance of the policies of the association favoring tax equality and opposing usurpation of the legislative function by administrative bodies.

Respectfully submitted.

John J. Goldberg, chairman; John M. Dickson; David H. W. Dohan; Harrison F. Durand; F. Daniel Frost; Delbridge L. Gibbs; Philip S. Habermann; Dan H. Shell; John Bell Towill; Henry L. Woolfenden.

Mr. DICKSON. In addition to individual or firm plans under H.R. 10 type legislation and the use of professional corporations, a third possible avenue for the self-employed person and his employees would be to participate in association or other group plans. The American Bar Association after careful study established a plan in 1963 for its members, but because of the severe restrictions in the 1962 act, the participation in this plan is extremely limited.

I recalled what Mr. Bress said to you. I listened with interest to Dr. Murray's testimony as to facts and statistics, and Mr. Clarke made a fine presentation on the subject.

It might be of interest to you to know that there are 118,000 members of the American Bar Association, and although it had a splendid committee, made up a good plan, brought in a splendid insurance company and bank, advertised it to the utmost, I think I will leave with you, if you care to see it, a copy of the American Bar Association Journal for August 1964 with an article by Mr. Nisen in which we tried to sell that plan.

Senator RANDOLPH. The subcommittee will give thought to including that also in the record.

Mr. DICKSON. That article was written in as nice a vein of selling as a lawyer could do it, I suppose, to try to get the lawyers to join in the ABA plan.

Out of all those people, only 420 plans of firms or individuals have been adopted, and only 858 people participate in those plans, out of 118,000 lawyers—and that number 858 includes lawyers and their employees who are in their plans.

We have a total of $2 million in those plans. I do not see how the country would have a tax or revenue loss of $3.6 billion when so-called rich lawyers do not come forward to a plan that their own people devised for them.

Undoubtedly, participation in such group plans would be greatly enhanced by passage of legislation as contained in the new H.R. 10.

In the light of the foregoing, our association is of the opinion that although several defects may remain in the 1962 law, passage of the pending H.R. 10 would most effectively and expeditiously bring about participation in retirement plans by responsible self-employed persons and their employees.

Therefore, it is our hope that this subcommittee and its parent committee will recommend that the Federal Government continue to encourage its citizens to assist in providing for their old age and to implement such policy by eliminating the inequitable barriers in the present tax laws and regulations.

In your invitation to testify, you included a list of questions in which you were interested. I have covered most of them in my comments, but I will briefly comment generally on the import of those questions not heretofore covered.

Certainly it is wise and proper for the Federal Government to encourage the extension of private pension coverage. The natural instinct of the responsible American is to provide for himself, and not to be dependent on others. As the Government encourages individual initiative, it lessens the demands upon it to provide for the needs of the aging.

Private pensions offer the employee a means for providing during his most productive period for his later years of lower income. The employer and the Government benefit by private pension plans for several reasons, the most obvious being their relief from the burden of future unplanned care of aging employees and former employees.

An immediate revenue loss to the Government would in fact be in the nature of a sound investment, because private pension plans would obviate the necessity of even larger Federal expenditures to provide for the aging, a substantial portion of the immediate loss would be recouped later by deferred taxes, and moreover, the investment of the privately contributed funds provide additional capital funds which are so necessary to support the economic expansion required to meet the demands of America's ever-increasing population.

In conclusion, we believe that if the Government desires to enable the many millions of self-employed and their employees to provide for their own retirement, the Congress should at least adopt the improvements sought by H.R. 10.

I realize we have directed our attention only to this one thing, but it is a phase of your study.

I found from Senator Morse's questions and Miss McCamman's answers interesting statements that there are other questions to be considered. I would volunteer the help of the experts on my committee to confer with your counsel any time you might desire their assistance.

I would like to commend the committee for bringing into proper focus a subject too long neglected in the light of the self-employed, and vital to all Americans.

Thank you.

Senator RANDOLPH. Thank you very much, Mr. Dickson.

Do your associates wish to make comment, or were they with you, perhaps, to assist you in making your statement?

Mr. NISEN. If I may, I would like to comment concerning the question Senator Morse put to Mr. Norman about the problem of protecting the aged from fraud.

I think that in H.R. 10 this is one piece of legislation where Congress has done this rather well, in the legislation itself, since in all plans that are trusteed plans, that is, uninsured plans, the assets must be held by a bank or trust company. They cannot be held by individual trustees.

As a matter of fact, under section 401, the corporate plans may have individual trustees, and often do. This is not true of H.R. 10. The protection in the area of protection of securities and investment of the fund is built into the act in that they must be held by a bank or trust company, or by an insurance company, in the case of the insured plans.

Mr. NORMAN. I take it, sir, you consider that to be a desirable provision in that piece of legislation, and that it would probably be desirable to transport it over to the section 401 type plans?

Mr. NISEN. I would not care to comment on that at all. I am merely trying to provide the answer to the problem insofar as it pertains to H.R. 10. I do not mean to suggest at all that there has been any real problem in the corporate plans, so far as the care of the assets are concerned.

I am not aware that there has been, and would not care to comment on that.

Mr. NORMAN. Mr. Dickson, in your prepared remarks, you mentioned three possibilities for obtaining pension coverage for attorneys, and their employees. The first is by improving H.R. 10, the second is by establishing professional service corporations, and the third is by a group plan.

Now, it is my understanding from your testimony that you would consider improving H.R. 10 as by far the most satisfactory method of obtaining coverage of these self-employed people, and you believe that most attorneys would be more likely to adopt plans under a liberalized H.R. 10 than to go into professional service corporations or to go into group plans, as they now exist.

Is that a correct conclusion from your remarks?

Mr. DICKSON. Personally, that is exactly how I feel.

I hear Mr. Nisen whisper that is not quite accurate. Maybe he would care to comment further. My own thinking is that is exactly correct. But it does one thing: If you improve H.R. 10, then when you go into a group plan, you make that ever so much more attractive.

Now, participation in that is economically better than, say, my firm setting up its own. If you can get into the group plan and then take some of the H.R. 10 benefits, you see, then you have one big group rather than where you might have 25 or 30 plans going. That is not economic.

Mr. NISEN. May I say this, the H.R. 10 legislation as it exists today, and would continue to exist with the amendments suggested by Mr. Dickson, covers both individual plans that a self-employed person or a partner might have for himself or a group plan such as the master plan of the American Bar Association, which it makes available to its members for group investment.

Improvement of H.R. 10 would improve both the individual and group plans.

I merely thought there was some connotation in your question, Mr. Norman, that perhaps that would not apply.

Mr. NORMAN. I am certainly glad you clarified that question. So in answer to my question, you would say a group plan under a liberalized H.R. 10 would probably be the most attractive alternative to attorneys in bringing themselves and their employees under coverage.

Would that be correct?

Mr. NISEN. In my opinion, that is precisely correct.

Mr. NORMAN. Under such a plan, if a secretary working for an attorney in Norfolk, Va., wanted to move to Chicago, Ill., and work for an attorney there, she could take her coverage with her, could she not, if they both had the same group coverage?

Mr. NISEN. If she was in the American Bar plan, and her employer were in that plan, she would have an account under that employer's plan.

Now, she can leave that account under that employer's plan. When she starts with her next employer, she would build up her account in the second employer's plan, whether it be in Chicago or not, and when she came to the age of 65 or selected age of retirement, she would then draw down from both accounts.

They would physically, in recordkeeping, be separate accounts; actually she would have investments in the same fund.

Perhaps I should clarify this. Normally, when an employee leaves a lawyer who has adopted the American Bar's plan, that employee is entitled to receive her benefits from the plan 1 year after the date her employment terminates. At that time, the employee has an option to either take down the funds accumulated for her in her first employer's plan as a lump sum or to use those funds to purchase an annuity. Now, if she elected to purchase the annuity using her first employer's funds, then, in that sense, she would be able to carry over from her first employer the funds built up in her first employer's plan and also continue to build up her account in the second employer's plan so that funds from both plans would be available to her at retirement.

Mr. NORMAN. But, of course, if she had not been under the first plan long enough to obtain coverage, her coverage would be lost if she would move to Chicago and wanted to work for an attorney there, would it not?

Mr. NISEN. In the same manner any employee under a corporate plan does not stay with that employer long enough to qualify, and moves to another employer; yes.

Mr. NORMAN. But if both employers have the same group coverage, she could go on without missing a step, so to speak, with the second employer, just as if she had remained with the first employer, and she would not lose any kind of pension coverage, would she, if they were both in the same pension plan?

Mr. NISEN. No, sir; that is not quite right, because each employer has a separate plan. The plans are only combined for administration and investment purposes.

Mr. NORMAN. You mean under your group plan they are separate plans, but they are pooled for certain purposes?

Mr. NISEN. Technically, each employer must have his own plan. This is pursuant to H.R. 10.

Mr. NORMAN. Would it not be an improvement, then, if I follow your testimony, to remove that requirement that each employer have his own separate plan and permit the American Bar Association, if it wanted to, to put in a plan under which any employee of an attorney throughout the United States could move to the employment of another attorney having the same group coverage without ever leaving the pension plan?

Would that not be an improvement in H.R. 10? Would it not be an improvement to remove the requirement that each employer have his own separate plan?

Mr. NISEN. I really have not considered that very deeply, because it would be a tremendous departure from the whole philosophy of pension and profit-sharing plans embraced in legislation since 1942.

Each employer has had his own plan. There have been negotiated union situations, as I understand it, where employer associations have worked out a method of transfer.

Mr. NORMAN. Are there not multiemployer plans? There is nothing new about them, or group plans. Have we not had multiemployer plans for many years?

Mr. NISEN. Yes; I think that is so.

Mr. NORMAN. Group plans?

Mr. NISEN. They have provided for transfer as a matter of plan provision itself. I do not know that legislation will be necessary if you get all of these employers to agree to this. Even with permissive legislation, you would have to get employers to agree to go into a group plan that permitted transfers of employees without a waiting period before being eligible to benefit from contributions by the second employer. Employers are slow to agree to contribute for employees who are untested.

Mr. NORMAN. Thank you very much, gentlemen.

Senator RANDOLPH. Mr. Dickson, we thank you and your colleagues for your presentation, and we trust you will give to the committee any further documentation you think might be helpful as the hearings proceed, and as the subcommittee considers this subject matter.

Mr. DICKSON. We appreciate the opportunity.

Senator RANDOLPH. Thank you very, very much. I believe it will be appropriate to insert at this point in the record, immediately after this excellent testimony by representatives of the legal profession, the text of two letters the subcommittee has received from spokesmen of two other fine American professions, the American Medical Association, and the National Society of Professional Engineers, and that will be done.

(The letters referred to follow:)

AMERICAN MEDICAL ASSOCIATION,
Chicago, Ill., March 1, 1965.

Senator JENNINGS RANDOLPH,
Chairman, U.S. Senate Subcommittee on Employment and Retirement Income, U.S. Senate, Washington, D.C.

DEAR SENATOR RANDOLPH: Your interest, and that of your committee, in encouraging businesses to provide retirement income through private pension plans for millions of Americans who are lacking this security is indeed commendable.

We want you to know that we share your interest. Indeed, the American Medical Association has an established pension plan which makes generous provision for its own employees. In addition, it has, for many years, urged the passage of an equitable law under which tax deferrred compensation plans may be established for self-employed individuals.

KEOGH LAW PROVIDES FOR RETIREMENT OF SELF-EMPLOYED INDIVIDUALS

As a matter of fact, such individuals were completely disenfranchised until 1962 when the Self-Employed Individuals Tax Act of 1962, better known as the Keogh-Smathers Act, was passed. This act permits self-employed individuals to establish pension plans for themselves and qualified employees. However, it is extremely restrictive in its application and confers only limited benefits. As a consequence, the act has not received wide acceptance.

It is interesting to note that, while the American Medical Association members retirement plan is acknowledged to be one of the more successful Keogh law plans, yet, as of January 31, 1965, there were only 3,256 individual trusts established. This figure represents a combined total of 5,436 self-employed physicians and their regular employees, in the face of an AMA membership which includes approximately 150,000 self-employed physicians. In other words, considerably less than 4 percent of the self-employed physicians have joined the AMA plan. While some have joined other non-AMA Keogh law plans, it is doubtful that more than 4 percent of the 150,000 have established such plans.

The fact that more Keogh law plans have not been established is not attributable to a lack of interest. Rather, it is due to the limited benefits available under the law. At present, a self-employed individual who is a sole proprietor or owns more than a 10-percent interest in a partnership may contribute annually on his own behalf to a retirement plan established under the Keogh law $2,500 or 10 percent of earned income, whichever is the lesser. Moreover, he is only entitled to deduct 50 percent of his allowable contribution, or a maximum of $1,250.

Representative Keogh's proposed amendments to the act (H.R. 10) would do much to revive an interest in this legislation since it would lift the "$2,500 or 10 percent of earned income, whichever is the lesser" limitation on contributions which self-employed individuals with employees could make toward a plan for his retirement. And, H.R. 10 would repeal the 50-percent deduction limitation.

Obviously, H.R. 10 bears a direct relationship to the objectives of this subcommittee which is to extend pension plan coverage to the millions of Americans who are without this security. The proposed amendments to the Keogh law would not only open the door for more self-employed individuals, but common-law employees for whom no retirement benefits are presently provided would also profit since coverage for a self-employed individual under the Keogh law is conditioned on coverage of qualified employees.

RETIREMENT PLANS THROUGH PROFESSIONAL CORPORATIONS AND ASSOCIATIONS

It is important to remember that the Self-Employed Individuals Tax Act of 1962 does not confer tax equality on professional people who constitute a large segment of the self-employed. The truth is that it falls far short of it. Even through the proposed amendments are a step in the right direction, they would fail to provide the tax equality which is available to nonprofessionals who, by the simple expedient of incorporating their enterprises, become employees of their corporations and share equally not only in retirement benefits under plans set up by the corporation but in other employee-fringe benefits as well. Accordingly, my concluding comments concern this problem of tax inequity and a proposal to remedy the situation through the enactment of legislation which would provide that professional corporations and associations are to be treated like other corporations for Federal income tax purposes.

Speaking for the self-employed physician, the sociological pressure for the group practice of medicine is a significant factor in the trend toward the practice of medicine in corporate form. While the AMA does not take a position for or against the practice of medicine in this form, it is opposed to discriminatory treatment of professional men whatever form it takes, whether taxwise or otherwise.

The fact is that there is nothing in the Internal Revenue Code which prohibits professionals from incorporating like nonprofessionals. Yet the administrative practices of the Treasury Department, which are in direct opposition to the objectives of your committee to provide security through private pension plans, arbitrarily discriminate against professional corporations or associations through the enactment of regulations which legislate rather than interpret the law. These regulations, which are commonly referred to as the Kintner regulations, are designed to prevent professional corporations or associations from qualifying as corporations for Federal income tax purposes.

H.R. 697 is intended to overcome the effect of the foregoing discriminatory practices of the Treasury Department by amending the definition section of the Internal Revenue Code of 1954, that is, code section 7701, to redefine the term "corporation" to include professional corporations and professional associations. If this could be accomplished, additional doors would be open to the establishment of private pension plans which would benefit millions of Americans.

Again, we commend you on your efforts in this area and submit that passage of H.R. 10 and H.R. 697 would help to achieve the objectives of this subcommittee.

Yours very truly,

F. J. L. Blasingame, M.D.,
Executive Vice President.

National Society of Professional Engineers,
Washington, D.C., February 26, 1965.

Hon. Jennings Randolph,
Senate Special Committee on Aging,
Senate Office Building, Washington, D.C.

Dear Senator Randolph: We have noted with interest that the Senate Special Committee on Aging will hold hearings on March 4–5, 1965, on the subject of extending private pension plan coverage.

This is a matter of considerable interest to us, particularly in connection with retirement plans for self-employed persons. Along with other professional societies, our organization was active in supporting passage of the Self-Employed

Individuals Retirement Act. The passage of this act by Congress has been of assistance in enabling self-employed professional engineers to provide some measure of protection for their retirement. However, as you are probably aware, the severe limitations in the act have been a deterrent to its full utilization and our experience has been that relatively few self-employed professional engineers have found it to their advantage to participate.

Two of the primary reasons for this situation are the 10-percent limitation on earned income, or $2,500 whichever is less, which may be invested in a retirement fund; and the allowable deduction of only 50 percent of the contribution to the retirement fund. We believe that if these two limitations were eliminated there would be a substantially larger participation in retirement plans for self-employed engineers. This would be of benefit not only to self-employed proprietors, but also to their employees which, as you know, must be covered on a nondiscriminatory basis to qualify the self-employed proprietor.

We understand that the Senate Special Committee on Aging is not a legislative committee and does not have direct jurisdiction over amendments to the present law. However, we believe that the subcommittee will be interested in reviewing this matter and, hopefully, make appropriate recommendations for amendment of the Self-Employed Individuals Retirement Act along the lines indicated above.

We would be pleased to provide any additional information or assistance which may be desired by the subcommittee.

Very truly yours,

PAUL H. ROBBINS, *Executive Director.*

Senator RANDOLPH. Our hearings this afternoon will resume at 2:15. There will be two witnesses, Mr. Hewitt and Mr. Severance.

Thank you very much.

(Whereupon, at 1:15 p.m., the subcommittee recessed, to reconvene at 2:15 p.m., the same day.)

AFTERNOON SESSION

Senator MOSS. The committee will come to order.

We will continue this afternoon with our hearings on extending private pension plan coverage.

Senator Randolph, the chairman of the committee, is unable to meet with us this afternoon because of an intervening requirement that he leave the city.

We have two witnesses to hear this afternoon. We had a very fine hearing this morning and we look forward to hearing from Mr. Edwin Shields Hewitt, a partner of Hewitt Associates and we will ask Mr. Hewitt if he will come to the witness table, and we will be glad to hear his testimony.

STATEMENT OF EDWIN SHIELDS HEWITT AND THOMAS H. PAINE ON BEHALF OF HEWITT ASSOCIATES, LIBERTYVILLE, ILL.

Senator MOSS. You may proceed, Mr. Hewitt.

Mr. HEWITT. Thank you, Mr. Chairman.

My name is Edwin Shields Hewitt. I am a partner in Hewitt Associates. Ours is a firm of consultants and actuaries helping organizations find answers to problems on pensions and employee benefits. Participating with me is my partner, Thomas H. Paine.

Senator MOSS. Fine, we are happy to see you, Mr. Paine.

Mr. HEWITT. I should say that even though we are a firm of consultants and actuaries, neither of us is an actuary.

We appreciate the opportunity to appear here today and discuss some of the basic issues involved in the extension of coverage under private retirement systems.

We are limiting ourselves today to a discussion of ways of extending coverage to try to help in stimulating the discussion of this phase of the questions that have been asked. We are doing so in the hope of being helpful to the committee.

We will try to direct comments to specific proposals rather than philosophical discussion. With your permission, Mr. Chairman, I would like to dispense with reading the statement which we have prepared and instead to summarize it and discuss it to the extent you care to have us discuss it.

Senator Moss. That would be very satisfactory. The entire statement will be made a part of the record and we would appreciate it if you would highlight it.

Mr. Hewitt. We would like to ask that it be made a part of the record.

(The statement of Messrs. Hewitt and Paine follows:)

PREPARED STATEMENT OF EDWIN SHIELDS HEWITT AND THOMAS H. PAINE

My name is Edwin Shields Hewitt. I am a partner in Hewitt Associates. Ours is a firm of consultants and actuaries helping organizations find answers to problems on pensions and employee benefits. Participating with me is my partner, Thomas H. Paine. We appreciate the opportunity to appear here today and discuss some of the basic issues involved in the extension of coverage under private retirement systems.

The announced objectives of this hearing are to consider "Federal policy to encourage businesses to provide pension coverage of those who are not now covered." This objective of extending private pension plan coverage is interpreted in this statement as meaning encouraging greater provision of retirement income through other than governmental systems.

In testimony before this committee in July of 1961 we directed a statement to the following questions:

1. What are some of the trends in the development of proviate plans today?
2. What are the alternative approaches to the proper division of responsibility among Government-sponsored forms of retirement income, private plans, and individual action?
3. What conditions are conducive to the continued growth of private plans?

A copy of this 1961 statement appears in the printed hearings.

Formal private retirement plans usually refer to those for which money is set aside in advance for the benefit of employees and which are qualified under section 401 of the Internal Revenue Code, including those plans made possible by the Smathers-Keogh Act. Such formal private retirement plans have had phenomenal growth in a relatively short period of time. Greatest activity has taken place among large employers. In manufacturing, transportation, and utilities, it is the rule rather than the exception for an employer of any significant size to be a sponsor of a retirement plan. It is likely that coverage, benefits, and liberality of protection for retiring employees will continue to increase. The results produced by the voluntary action of employer-employee groups must obviously be regarded as highly successful.

However, the degree of progress made to date does not necessarily guarantee a gradual expansion to cover the vast majority of the work force with private retirement plans under existing legislation. A breakdown[1] of the entire work force reveals the extent of coverage under formal retirement plans (private and public) as follows:

Covered: 23.5 million nonagricultural workers, 7.2 million Government workers, unknown number of self-employed.

Partially covered: 2.7 million armed service.

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[1] See apps. A and B for further details pp. 78 and 79.

Not covered: 24 million nonagricultural workers, 2.3 million Government workers, 1.7 million agricultural workers, 8.6 million self-employed (includes the unknown number of self-employed with coverage shown above), 1.4 million unpaid family workers, 4.2 million unemployed.

A forecast of the future spread of retirement plans must take into account the location of the principal groups of uncovered persons. With respect to the single largest group, the 24 million nonagricultural workers, it should be recognized that these persons work for enterprises of smaller average size than those which operate plans today. It is likely that progress will be particularly slow among employers of this limited size.

At least three reasons can be cited for the smaller employer's reluctance to act:

1. Generally he has had less reason for maintaining a program of retirement benefits for his employees than the larger organization. In hiring and holding employees, the competitive influence of pensions among small companies has not been significant.

2. Many of the advantages in sponsoring retirement programs are not applicable to the smaller employer, or at least he does not recognize these advantages.

3. The present cumbersome procedures for qualifying and maintaining plans appear as impediments to the small employer.

National policy has been to increase the growth of private efforts to put aside funds for retirement. The principal expression of this policy has been the use of so-called tax incentives. This device has been particularly successful for the larger employer. More recently, it has been extended to individuals on a modified basis under the Smathers-Keogh legislation. In addition, tax-sheltered annuities can be applied to employees of nonprofit organizations and public schools.

In spite of the number of devices which involve preferential tax treatment, we should recognize that tax incentives are not necessarily the answer to the question of how best to encourage private retirement plans.

DEFINING THE ROLE OF TAX INCENTIVES

Perhaps it is because of the successful spread of private retirement plans that we tend to assume that incentives provided through tax legislation have been a necessary factor in that growth. Who has been given an incentive? To do what? The answers to these questions may help to indicate future trends in the growth of private plans. We should not take for granted that continuation of incentives in their present form will necessarily result in substantial future growth.

What role do tax incentives play in the determination of employer action? It is erroneous to assume that a company desires to start and to maintain a plan because it receives a tax deduction for its contributions, since the same amount of deduction would be available if a like amount of money were paid in wages. Therefore, we would be more accurate if we said that in most instances the employer establishes and maintains a plan for reasons completely apart from tax considerations. These reasons may relate to the company's goals, such as having the ability to remove in an orderly manner the too-old worker from the work force, building morale and a sense of security, being competitive with other firms, and making sure that career employees are not in want when they can no longer work. The reasons for maintaining a plan may also include the desire of employees to put aside money for later use without paying tax at the time the money is saved.

Because of the existence of employer and/or employee objectives, the company is willing to start a retirement plan. There is nothing to prevent the employer from accepting a commitment to pay pensions to retirees and to meet these objectives from current revenue as the payments come due. This course of action is followed with an unfunded plan. Usually, however, the employer wishes to fund this liability in advance for a variety of reasons. For example:

1. He wishes to further protect employees so that their expectations for retirement income will be realized.

2. He recognizes that he has incurred a liability which grows over time and he is reluctant to pass this growth on to future managements.

3. He wants to arrive at an appropriate distribution of pension charges between present and future years for accounting purposes.

With no specific incentive legislation or regulations in effect, what would the employer do? The employer who wishes to maintain a plan and to advance fund for its liabilities can contribute money to a trust or insurance arrangement on an irrevocable basis. Since the company no longer has any incidence of ownership, it is logical to claim the contribution as a business expense in the year contributed. Since the employee has not constructively received any income, it is logical for him to claim no taxable income until benefits are actually received in retirement.

Therefore, even in the complete absence of pension rules and regulations related to preferential tax treatment, retirement plans could be started and ways found to fund in advance for their costs. The supposed tax incentives are really restrictions which are placed on the choices available to the employer. These regulations prescribe limits to action in terms of the group covered, the type of benefit, the amount of contribution, etc. As such, they really constitute a negative incentive. An employer is required to shape his plan in certain ways in order to "qualify" his plan. The trend has been to more cumbersome regulations which keep reducing the employer's choice of action if he is to retain the desired form of tax treatment.

For purposes of the present discussion of ways to extend the growth of private retirement plans, the preceding analysis might lead to three conclusions:

1. Pension plans are not started or maintained primarily because of so-called tax incentives. There must be legitimate employer and/or employee objectives to be met before action is likely to be taken.

2. As we continue to impose further requirements, we will tend to make pensions less attractive by narrowing further the choices available to an employer.

3. As the trend toward more tax regulation continues, the burden on smaller employers in adopting and maintaining a plan may be considered to be too great in their eyes. Simplification of the system or an alternative arrangement is needed to overcome this reluctance.

Perhaps we could express the problem of future growth in retirement plans in another way: Private plans have become most prevalent in situations where employer and/or employee objectives have been best served by these programs. This growth has occurred along with, not because of, so-called preferential tax treatment.

If public policy is to continue to be expressed by preferential tax treatment for private retirement programs, future growth, we believe, cannot be achieved by primary dependence on existing tax regulations. Rather, the spread of private plans may be related to the extent to which the same conditions of need are judged to exist on the part of more employers and employee groups.

FINDING A MORE UNIVERSAL APPROACH

Thus, we must recognize that we cannot achieve the objective of maximization of private efforts to promote retirement income solely through so-called tax incentives to business. We must look for avenues which lie outside the employer-employee relationship. In addition, there must be a method to apply tax regulations on a relatively equal basis to the individuals who work for a large corporation; those who work for a small employer; and those who work for themselves.

What are the characteristics of a program to extend encouragement of private forms of retirement income through the form of tax incentives?

1. *Universality.*—There must be one system which allows all income producers to have an opportunity to accumulate retirement income: whether they work for a corporation; work for a sole proprietor or partnership; or are themselves sole proprietors or partners.

2. *Equality.*—Since tax laws and regulations produce a form of subsidy for those who take advantage of them, they should be available to taxpayers on a relatively equal basis. Because of the variety of individual employment circumstances, equality cannot be achieved through programs restricted to an employer-employee mechanism. Therefore, the incentive should be equalized through tax adjustments for the individual, universally applied. While action will become more effective when it is group sponsored, tax incentives should not penalize those who are necessarily dependent only on individual action.

3. *Simplicity.*—Even if a suitable mechanism is available, its use may be severely restricted unless the arrangement for universal and equal treatment operates in a simple manner. This, in turn, requires a single measure of tax deferment as well as administrative simplicity.

4. *Flexibility of choice.*—Any mechanism meant to apply on a universal basis to individuals in vastly differing circumstances must have the structural flexibility to allow a variety of objectives to be met through a wide choice of methods and rates of individual savings. In general, the wider the flexibility, the greater the appeal to the largest number of persons.

5. *Economy.*—Maximum encouragement of private provision for retirement will be available only if the program allows the objectives to be met at the minimum administrative cost in time and money for the participant, resulting in the maximum amount of savings being used to provide benefits.

If the objectives of maintaining private systems of retirement income are judged desirable; if the policy of encouraging this through tax incentives should be furthered; and if the characteristics stated above appear appropriate in defining such action as may be taken to achieve these objectives, it would seem appropriate to thoroughly explore and develop a workable alternative. There should be no deterrent to such exploration because it would produce a substantial departure of or modification of the present form of pension systems.

Attached is an illustration—not a specific proposal—of one kind of program that might be developed to achieve a consolidated approach applicable to all segments of the working population for providing tax incentives for retirement accumulation. It is being presented in the hope that it can stimulate thinking of new avenues of exploration which should be considered.

In its simplest terms, the idea is this: Any employer or individual could establish a qualified retirement plan in a manner that would not have the detailed requirements of the present Internal Revenue Code regulations. Contributions to such a plan, within prescribed limits, could be made and deducted for tax purposes by either the employer or the individual. All employees and individuals could participate, although the limits on contributions under this mechanism would be reduced for those participating in existing plans by the values of contributions made to such existing plans. Contributions would be placed with approved depositories for investment. Distributions to individuals would be permitted upon retirement or other prescribed conditions; such as, permanent disability or death, and included in taxable income when paid.

What could such a program accomplish?

1. Employers who have not adopted plans would be given an incentive to do so by making available a simple mechanism for qualification.

2. Individuals would be given an incentive for saving for retirement through deductions in current income taxes.

3. A degree of equity would be provided among employees covered by different private pension plans by allowing those who have lesser employer-paid benefits the opportunity to augment tax-deductible savings for retirement purposes.

4. A method of accumulating tax-deferred earnings would be made available to the self-employed on a basis more comparable to that enjoyed by the employee of a corporation than is provided by existing legislation.

Perhaps we can describe one set of possible specifications for tax treatment which implements the idea, to give you a better understanding of some of its possibilities and limitations.

Each individual might have an allowable deduction consisting of two parts:

1. Retirement accumulation for the current year—up to 7½ percent of annual income.

2. Retirement accumulation for past years for which his allowable credit was not fully taken—up to 7½ percent of annual income.

The maximum allowable deduction, if an individual were eligible for maximum credit under both parts, would be 15 percent—the present limit for qualified profit-sharing plans.

The contribution could be made by the employer, the individual, or shared. The party actually making the contribution would receive the tax deduction.

The 7½ percent of income which would be allowable for the current year would be reduced by the value of employer contributions to another qualified plan.

1. In the case of a profit-sharing or money-purchase pension plan, the actual amount of such contribution would be deducted from the 7½-percent maximum.

2. In the case of a fixed benefit pension plan, the deduction would equal an amount presumed to represent the value of the benefit earned for that year. Assuming that the individual's total retirement income is being level funded for 40 years beginning at age 25, the value of the fixed benefit is approximately equal to six times the annual benefit earned. For example, under a pension plan providing a monthly benefit of $2.50 times years of service, the deduction

for the employer-sponsored pension would equal the annual $30 (12 times the monthly $2.50 benefit) multiplied by 6, or $180. An employee earning $4,000 per year would have a maximum deduction of 7½ percent of $4,000, or $300. Deducting the $180 credit for the pension plan would leave him with a net allowable deduction for a personal plan of $120.

The amount which could be an allowable deduction for past service would be based on a concept of level funding in the future for past contributions not made. The maximum past service credit would equal 7½ percent of current income multiplied by the number of years between age 25 and the individual's present age. From the maximum past service credit would be deducted the amount of contributions already made, either by the individual or by an employer in his behalf. The net credit would then be funded over the remaining years to retirement, but could not exceed 7½ percent of income deducted per year.

For example, if a man earning $4,000 were 40 years old today, his maximum past service credit would be 7½ percent of $4,000, or $300 times 15 (his years since attaining age 25) or $4,500. Let's assume that he had been covered by the $2.50 pension for 10 years by age 40. This would provide a benefit earned to date of $25 per month, or $300 per year. Multiplying by 6, the pension would be an $1,800 offset to his past service credit. The remaining $2,700, level funded for the 25 years to retirement, would equal $108 per year. This amounts to 2.7 percent of his pay.

By outlining this idea, our intention has been to stimulate discussion of possible approaches. We are not attempting to suggest a final proposal for action. We feel that the problems of extending opportunities for accumulating retirement income to the small employer, and having greater equity of treatment for all persons regardless of employment status, are critical ones if the principle of private action in the retirement field is to prosper and grow. It is in this context that we put forth this idea as one possible basis for further discussion.

APPENDIX A

U.S. population, employment, and pension coverage, 1963

[Data in thousands]

	Total	All private nonagricultural industries	Agriculture	Unemployed	Government	Armed Forces
Number of business operations	8,439.7	[1] 4,797.0	[2] 3,642.7			
Corporations	1,219.0	[2] 1,200.0	[2] 19.0			
Other	7,220.7	3,597.0	[2] 3,623.7			
Number of employed persons	75,712.0	[3] 54,328.0	[3] 4,946.0	[3] 4,166.0	[3] 9,535.0	[3] 2,737.0
Paid wage and salaried workers	65,659.0	[3] 47,546.0	[3] 1,675.0	[3] 4,166.0	[3] 9,535.0	[3] 2,737.0
Self-employed	8,632.0	[3] 6,195.0	[3] 2,437.0			
Unpaid family workers	1,421.0	[3] 587.0	[3] 834.0			
Employee pension coverage	30,747.0	[4] 23,500.0			[5] 7,247.0	
Multiemployer plans	4,000.0	[4] 4,000.0				
Private plans	19,500.0	[4] 19,500.0				
Total private plan coverage	23,500.0	[4] 23,500.0				
Government employees	7,247.0				[5] 7,247.0	
Workers not covered	42,228.0	30,828.0	4,946.0	4,166.0	2,288.0	
Employees	28,009.0	24,046.0	1,675.0		2,288.0	
Self-employed	8,632.0	6,195.0	2,437.0			
Unemployed	4,166.0			4,166.0		
Unpaid workers	1,421.0	587.0	834.0			
Workers partially covered	2,737.0					[3] 2,737.0

[1] U.S. Department of Commerce.
[2] U.S. Treasury Department, Internal Revenue Service.
[3] U.S. Department of Labor.
[4] President's Committee on Corporate Pension Funds and Other Retirement and Welfare Programs
[5] Institute of Life Insurance.

Appendix B

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	4,166,000	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	1,421,000	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	2,288,000	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	8,632,000	This group is composed of 2,437,000 self-employed persons in agriculture and 6,195,000 self-employed in nonagricultural industries. The self-employed have been "potentially eligible" for pension coverage since the enactment of special legislation in 1962. Although 7,000 plans were approved during the 1st half of 1964, there are no data available showing the number of individuals 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 is the fact that their tax incentive is considerably less than that enjoyed by employees of corporations. Legislative proposals have been introduced to eliminate this discrimination.
Agricultural workers	1,675,000	A sizable portion of this group is employed by the 2.5 million 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.	24,046,000	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 does 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 programs—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 worked 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 24,000,000 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 1963 a total of 42,228,000 were without pension coverage.

APPENDIX C

SUMMARY OF A CONSOLIDATED APPROACH, APPLICABLE TO ALL SEGMENTS OF POPULATION, FOR PROVIDING TAX INCENTIVE FOR RETIREMENT ACCUMULATION

(The term "retirement accumulation" includes but is not limited to funds set aside under plans qualified under current legislation in section 401(a) of the Internal Revenue Code. The new all-inclusive arrangement for deferment of tax on funds set aside for retirement contemplates simplified administration through individual income tax computation.)

Objectives

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.

Method

1. One or more individuals or one or more employers can establish a qualified retirement accumulation plan by entering into an arrangement under which contributions are transferred to a corporate fiduciary institution as trustee, or an insurance company, or are used to purchase authorized bonds, and are held in conformance with the distribution conditions governing such plan.
2. Contributions may be made by either the individual or by an employer on behalf of an individual employee:
   (*a*) Employer contributions are deductible by the employer as compensation to the employee.
   (*b*) Individual contributions are deductible by the individual from his adjusted gross income.
3. An individual may deduct from adjusted gross income an amount up to the allowable deductible contributions set forth below. This amount shall be from all sources including:
   (*a*) His own contributions to a qualified retirement accumulation plan or to a plan qualified under section 401 of the Internal Revenue Code which permits employee contributions and which also meets the distribution conditions set forth below.
   (*b*) Contributions by any employer to any qualified retirement accumulation plan on his behalf, or
   (*c*) The value of contributions or benefits to his account or for his benefit under any plan qualified under section 401 of the Internal Revenue Code.
4. To simplify the adoption of plans by individuals or small employers, standard approved plans would be made available which would eliminate the detailed qualification requirements of an individually prepared plan.

Allowable deductible contribution

1. The maximum allowable deduction in any tax year will be the sum of (*a*) and (*b*) below:
   (*a*) An amount equal to 7½ percent of the individual's earned income, as defined below, less:
      (1) The actual amount contributed by the individual's employer on his behalf either to a qualified retirement accumulation plan or to a plan qualified under section 401 of the Internal Revenue Code, and credited to his individual account under either such plan or used to purchase individually identifiable benefits earned during the tax year, if any, and
      (2) The actuarial value of benefits earned by the individual during the tax year under a fixed benefit plan qualified under section 401 of the Internal Revenue Code, 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 benefit earned in the tax year).

(b) An amount equal to 7½ percent of the individual's earned income, as defined below, but not more than:

(1) 7½ percent of earned income for the tax year multiplied by the number of years from the taxpayer's age 25 to his attained age in the tax year, less the total of:

(a) The amount deducted in previous tax years by the taxpayer as contributions to a qualified retirement accumulation plan, plus

(b) The amounts contributed to an employer qualified plan by the individual's employer and credited to his individual account or used to purchase individually identifiable benefits in previous tax years, if any, plus

(c) The actuarial value of benefits earned in previous tax years under a fixed benefit employer qualified plan, if any, determined in accordance with standards to be established by the Internal Revenue Service as to the value of benefits provided (e.g., six times the amount of benefit earned to date).

In any tax year in which any part of the total contribution by or on behalf of an individual to a qualified retirement accumulation plan shall be in excess of the maximum allowable deduction, to the extent that such excess is not withdrawn within 6 months after the end of the tax year, no tax deduction will be allowed for any part of such contribution and the entire contribution shall be refunded and included as taxable income.

2. Earned income is income in any tax year which is, or which would be except for limitations as to maximum amount, subject to social security taxes. The amount of earned income for any tax year will be the greater of:

(a) The amount of earned income in such tax year, or

(b) The average of earned income in the last 5 tax years.

3. Any investment earnings of any fund shall be excluded from taxation.

4. The total of all contributions which are taken as tax deductions by an individual cannot exceed (a) reduced by (b) below:

(a) Three times the amount of earned income as defined under section 2.

(b) Any amounts contributed by an employer and the actuarial value of any benefits earned under an employer plan as determined under section 1 a and b (1) (b) and (c).

If, at the time distributions from the plan commence, an excess exists, a distribution shall be made from the plan within 6 months after the end of such tax year in an amount determined by multiplying the then market value of the assets attributable to the contributions made by the percentage arrived at by dividing the amount of excess determined above by the total amount of all contributions taken as tax deductions. Such distribution shall be taxed as ordinary income, but not to exceed the rate at which 20 percent of such distribution would have been taxed in the preceding tax year had it been received in addition to an adjusted gross income equal to the individual's earned income as determined for section 2.

Distributions from plan

Distributions would be taxed when received, as follows:

1. If paid on or after the 60th birthday and no later than the 70th:

(a) If paid as an annuity or in equal installments over a period of at least 10 years—as ordinary income.

(b) If paid in a lump sum or in installments other than in equal amounts over a period of 10 years—as ordinary income, but not to exceed the rate at which such distribution would have been taxed had 20 percent of it been received as additional ordinary income in the year of the highest taxable income out of the 5 years preceding the first year in which distributions take place.

2. If paid on account of disability, as defined under social security, occurring prior to the 60th birthday—same as 1.

3. If paid to a beneficiary on account of death—same as 1.

4. If paid prior to the 60th birthday:

(a) If in an amount equal to less than 25 percent of average taxable income during the previous 5 years—as ordinary income.

(b) If greater than the amount in (a)—as ordinary income but not to exceed 110 percent of the rate at which such distribution would have been taxed had it been received in equal installments as additional ordinary income in the previous 5 years.

5. If paid after the 70th birthday, the individual will be taxed as though distributions were made in equal installments beginning on his 70th birthday.

Mr. HEWITT. Our statement attempts to make four principal points. Number one, the growth in private retirement plans has been substantial and we believe beneficial to our society. The principal reason for this growth, sometimes erroneously thought to be due to the presence of preferential tax treatment, have involved the personnel and security objectives which the employer and/or the employee have been able to get accomplished.

Second, we believe that if public policy is to continue to be expressed by preferential tax treatment for private retirement programs, future growth cannot be maximized by primary dependence on existing tax regulations. We have attempted to give our breakdown of the potential from the standpoint of coverage as an appendix to our report. Because the largest group of uncovered persons works for smaller employers who have been less motivated to establish private plans, we believe that we can best achieve further expansion by looking for avenues which are not directly dependent upon the employer-employee relationship, or entirely dependent on it.

Third, the characteristics of a program which will be likely to maximize private coverage would include the following: One is the characteristic of universality, or one mechanism, which allows all income producers to accumulate retirement income whether they work for a corporation, work for a sole proprietor, or are themselves sole proprietors.

This reflects many of the comments made by witnesses this morning except we are trying to suggest the possibility of going beyond any one specific type of program to seek a way in which a mechanism within the tax system could be developed which would be applied overall to all groups.

The second characteristic that we think would be important would be equality or relatively equal tax treatment through tax adjustments applied to the individual; this would be arrived at through the individual income tax mechanism with individual computations in order to have equal tax treatment for all segments of the working force.

Third, one of the characteristics should be simplicity to the extent that a very complex problem can be made simple, or the use of a single measure for tax deferment to facilitate administrative handling.

Finally, we believe it should be something that has flexibility so that the greatest number of persons can achieve their own objectives through a universal private system with a maximum degree of individual choice.

These characteristics can be achieved through a program which might be developed with the cooperation of many people and groups. A specific example that we will talk about has been developed solely for the purpose of illustrations. Our own conclusion or strong suspicion is that while this may seem difficult it likely is quite possible.

I will turn to the prepared statement starting on page 10 of the statement submitted to you.

If the objectives of maintaining private systems of retirement income are judged desirable, if the policy of encouraging this through tax incentives should be furthered, and if the characteristics stated above appear appropriate in defining such action as may be taken to achieve these objectives, it would seem appropriate to thoroughly explore and develop a workable alternative.

Although it is possible that it might not require substantial changes in the present arrangements there should be no deterrent to such exploration because it would produce a substantial departure of or modication of the present form of pension systems.

Attached is an illustration, not a specific proposal, of one kind of program that might be developed to achieve a consolidated approach applicable to all segments of the working population for providing tax incentives for retirement accumulation.

A similar idea was included in our statement in the 1961 hearings. It brought forth some interest, particularly on the part of Senator Smathers who asked us to develop this further in more detail and more specifically. Because of the circumstances of the legislation then currently being enacted, known as the Smathers-Keogh legislation, we did not proceed to fulfill his request at that time. We hope that this statement today will fulfill that request and we are submitting it in somewhat more detail, further illustrating the concept involved. It is being presented in the hope that it can stimulate thinking of new avenues of exploration.

In its simplest terms, the idea is this: Any employer or individual could establish a qualified retirement plan in a manner that would not have the detailed requirements of the present Internal Revenue Code regulations.

Contributions to such a plan, within prescribed limits, could be made and deducted for tax purposes by either the employer or the individual. All employees and individuals could participate, although the limits on contributions under this mechanism would be reduced for those participating in existing plans by the values of contributions made to such existing plans.

Contributions would be placed with approved depositories for investment. Distributions to individuals would be permitted upon retirement or other prescribed conditions such as permanent disability or death, and included in taxable income when paid.

What could such a program accomplish?

First, employers who have not adopted plans would be given an incentive to do so by making available a simple mechanism for qualification.

Second, individuals would be given incentive for saving for retirement through deductions in current income taxes.

Third, a degree of equity would be provided among employees covered by different private pension plans by allowing those who have lesser employer-paid benefits the opportunity to augment tax-deductible savings for retirement purposes. This would include the deductibility of employee contributions to existing plans, as suggested this morning.

Fourth, a method of accumulating tax-deferred earnings would be made available to the self-employed on a basis more comparable to that enjoyed by the employee of a corporation than is provided by existing legislation.

Perhaps we can describe one set of possible specifications for tax treatment which implements the idea, to give you a better understanding of some of its possibilities and limitations. The figures that we use are for illustration of the principle involved only.

Each individual might have an allowable deduction consisting of two parts:

First, retirement accumulation for the current year—up to 7½ percent of annual income.

Second, retirement accumulation for past years for which his allowable credit was not fully taken—up to 7½ percent of annual income.

The maximum allowable annual deduction, if an individual were eligible for maximum credit under both parts, would be in this illustration 15 percent—the present limit for qualified profit-sharing plans.

The contribution could be made by the employer, the individual, or shared. The party actually making the contribution would receive the tax deduction. The 7½ percent of income which would be allowable for the current year would be reduced by the value of employer contributions to another qualified plan. This could be a plan of the usual corporate type or a plan under the Smathers-Keogh legislation.

First, in the case of a profit-sharing or money-purchase pension plan, the actual amount of such contribution would be deducted from the 7½-percent maximum.

Second, in the case of a so-called fixed-benefit pension plan, the deduction would equal an amount presumed to represent the value of the benefit earned for that year. Assuming that the individual's total retirement income is being level funded for 40 years beginning at age 25, we can say that the value of the fixed benefit is approximately equal to 6 times the annual benefit earned.

For example, under a pension plan providing a monthly benefit of $2.50 times years of service, the deduction for the employer-sponsored pension would equal the annual $30—12 times the monthly $2.50 benefit—multiplied by 6 or $180. An employee earning $4,000 per year would have a maximum deduction of 7½ percent of $4,000 or $300. Deducting the $180 credit for the pension plan would leave him with a net allowable deduction for a personal plan of $120.

The amount which could be an allowable deduction for past service would be based on a concept of level funding in the future for past contributions not made. The maximum past service credit would equal 7½ percent of current income multiplied by the number of years between age 25 and the individual's present age.

From the maximum past service credit would be deducted the amount of contributions already made—either by the individual or by an employer in his behalf. The net credit would then be funded over the remaining years to retirement, but could not exceed 7½ percent of income deducted per year.

For example, if a man earning $4,000 were 40 years old today, his maximum past service credit would be 7½ percent of $4,000 or $300 times 15—his years since attaining age 25—or $4,500. Let's assume that he had been covered by the $2.50 pension for 10 years by age 40. This would provide a benefit earned to date of $25 per month or $300 per year. Multiplying by 6, the pension would be $1,800 offset to his past service credit. The remaining $2,700, level funded for the 25 years to retirement, would equal $108 per year. This amounts to 2.7 percent of his pay.

By outlining this idea, our intention has been to stimulate discussion of possible approaches, to widen our range of consideration in an attempt to make sure we are considering all possible alternatives to finding the answer to what is most obviously a difficult question.

We are not attempting to suggest a final proposal for action. We feel that the problems of extending opportunities for accumulating retirement income to the small employer, and having greater equity of treatment for all persons regardless of employment status, are critical ones if the principle of private action in the retirement field is to prosper and grow. It is in this context that we put forth this idea as one possible basis for further discussion.

Senator Moss. Thank you very much, Mr. Hewitt.

Mr. Paine, do you have comments you would like to add?

Mr. Paine. No, Senator.

Senator Moss. Of course, these tables that you have appended here will explain in part what you are presenting here in your summary.

Mr. Hewitt. Yes.

Senator Moss. Let me see if any of our staff members have any questions.

Well, apparently you have made it clear to us what you are putting forward for our consideration in exploring this field and we appreciate it very much.

Mr. Hewitt. I think, sir, we are trying to suggest there are many answers to this problem. We would hope that we take a careful look at as many of them as possible. We appreciate this opportunity of being here.

Senator Moss. Thank you, we appreciate seeing you and Mr. Paine.

(The following statement was subsequently submitted by Messrs. Hewitt and Paine in response to a question presented to them.)

In our statement we raise the question as to the impact of tax incentives on the growth of private retirement funds.

Much has been said about the extent of the so-called tax subsidy granted to private retirement plans by the Federal Government. Proposals for the liberalization of restrictions for both corporate-sponsored and individual retirement plans are sometimes met by negative reactions from the Treasury Department because of the anticipated tax loss involved. Proposals for further curtailment in the choices open to private plans may be considered justified on the basis of the quasi-public character imputed to private plans because of this so-called tax subsidy.

A clarification of the real nature of tax incentives can help shed light on appropriate public policy for private plans. From a quantitative standpoint the important question may be this: Does the potential value of future retirement income from private plans justify the amount of tax loss suffered currently by the Government?

Preliminary to a quantitative analysis is an understanding of who gets the tax advantage. There are two types of tax breaks involved in private plans.

One is the deductibility of contributions made to a pension plan by an employer with no current tax liability to the covered employee. Whose tax advantage is this? It is not likely to be the employer's since it is most probable that if no retirement plan existed, compensation would be correspondingly higher. Certainly, contributions to private plans agreed upon in collective bargaining usually are substitutes for like amounts paid as wages which are an equally deductible expense to the employer. Similarly, as indicated in our statement, "There is nothing to prevent the employer from accepting a commitment to pay pensions to retirees and to meet these objectives from current revenue as the payments come due." In such case, of course, such retirement payments would be fully deductible by the employer. Furthermore, in the case of employer-paid retirement plans of Government or nonprofit organizations, there is no question of tax deductibility by the employer although individual participants are permitted tax deferment on employer contributions and accumulations. Clearly, public policy has established that the tax break is the employee's and constitutes the deferment of taxes by the employee until time of receipt of benefits.

The other form of tax break is tax exemption of retirement fund earnings. Investment income is allowed to accumulate with no tax liability until benefits are actually received. In this respect, qualified retirement plans are treated in a similar manner to certain forms of individual life insurance contracts and U.S. Government savings bonds with deferment of tax liability on interest earnings. This tax advantage also belongs to the employee since he is being allowed to postpone taxes.

Judged from an economic standpoint, both forms of tax breaks in private retirement plans are advantages to the covered employee. Any analysis of tax loss incurred because of such plans thus involves evaluating how much additional revenue would have been collected in individual incomes taxes from covered employees had taxes been assessed currently on both pension contributions and investment earnings.

An approach to comparing the value of retirement plans with the tax loss suffered by the Government may be found in an illustration of retirement income for one person and the tax loss involved. Suppose an employer agrees to set aside 10 cents per hour for each participant in a private plan. Assume further that the contributions can be invested to yield growth of 5 percent per year, compounded annually. If a man is covered by such an arrangement for 30 years, what retirement income is created? What tax loss is suffered?

1. RETIREMENT INCOME CREATED

The 10-cent-per-hour contribution amounts to $200 per year going into the fund plus investment income. After 30 years of participation at age 65, this is sufficient to produce a full cash refund life annuity of $97 per month or $1,164 per year.

2. TAX LOSS SUFFERED

One source of tax loss is the tax-deferred treatment of the employer's contributions to the plan. If the 10 cents per hour had been paid in wages and the employee were in the 20-percent-tax bracket, the Government would have received $40 per year more in taxes. Over 30 years the total of these annual amounts forgone in taxes on contributions to the plan on behalf of this man amounts to $1,200. In addition, tax revenue is lost because earnings on invested funds are not taxed currently. The total of these interest earnings over the 30-year period is $7,645. Again assuming a 20-percent-tax bracket for the employee, the total of the annual amounts forgone in taxes on earnings amounts to $1,529. Assuming annuity payments continue for the 15-year life expectancy of the individual; assuming interest earnings on the decreasing fund; and assuming a 10-percent-tax bracket for the employee after retirement, the total of tax revenue lost on these earnings because such earnings are not taxed currently is $450. Total from all three sources is $3,179 in this example.

3. POSSIBLE TAX RECOVERY

Income paid in retirement is taxable since no tax has been paid at the time of contribution or at the time investment income was realized. Assuming double exemptions after age 65, and lower income from other sources, the effective tax rate will probably be small and may be nonexistent. If we assume a modest amount of other income for the man in our example, we might assign an effective tax rate between 0 and 10 percent of his retirement income. Applying this to the value of his pension to be paid in retirement, we might expect up to $1,746 to be recovered by the Government in taxes.

4. COMPARING RETIREMENT INCOME CREATED WITH TAX LOSS SUFFERED

In this example, the private pension plan has created total retirement income payments of $17,460, assuming a life expectancy of 15 years. This has cost the Government $3,179 in taxes forgone over a 30-year period before retirement and a 15-year period after retirement of which up to 55 percent will be recovered through taxes after retirement.

Expressed in its simplest terms, for each $10 in retirement income created the Government has suffered a tax loss of $1.82 which may be cut to 82 cents by payment of taxes after retirement.

The same general principle applies if the analogy is expanded from 1 man covered by 1 plan to 24 million persons covered by thousands of plans. Somewhere between $5.50 and $12.20 of retirement income is being created by private plans for each $1 being forgone in taxes by the Government.

Nor does this analysis take account of the possibility that if the private plan were not providing this amount of retirement income, the Government might have to spend its $1 of net tax loss, or more, to assure a decent living standard for this man after retirement.

Assuming that growth of private retirement plans has resulted from public policy which encourages private pensions through preferential tax treatment, does the potential value of future retirement income from private plans justify the amount of tax loss suffered by the Government? The objective of more adequate income for our aging population certainly appears to justify an affirmative answer. In fact it is hard to imagine a form of investment by the Government with better return to our society. If this is true, preferential tax treatment for private forms of retirement income should be extended to more segments of our population and granted all possible encouragement through maximum freedom of individual choice.

Senator Moss. We will now hear from Mr. H. L. Severance.

STATEMENT OF H. L. SEVERANCE, STANDARD OIL CO. OF CALIFORNIA

Mr. Severance. Thank you, Mr. Chairman, my name is H. L. Severance. I am secretary of Standard Oil Co. of California.

For many years, I have been a member of the annuities committee of our company, which administers our annuity plan and other benefits for employees. I am also administrator of the stock plan for employees of that company and its subsidiaries. I do appreciate the opportunity to appear before you today.

I have come here from San Francisco because I believe our company has been one of the leaders in industry in providing generous retirement benefits for its employees. Not being an actuary or a lawyer, but simply a businessman who knows something about costs, competition, and business motivation, I would like to tell you briefly about our retirement plans in Standard Oil Co. of California. In light of these, my testimony bill bear on quite a few of the list of 18 questions to which this committee seeks answers.

Standard Oil Co. of California started its first pension program in 1903. The plan has been amended, always with improvement in mind, many times—the last change being in 1957 at which time we geared a portion of retirement pay to final compensation and liberalized vesting provisions. Our plan is fully funded. Employees contribute to the plan and membership is a condition of employment.

In 1952, because of our concern about the drop in the purchasing power of the dollar, we installed a supplementary retirement program known as our stock plan. Here the company payment is a function of profits; employees deposit monies voluntarily through payroll deduction—and all cash received by the trust is used to purchase company common stock in the open market. Lump sum stock payments are made on retirement.

Our company has more than 50 union contracts and these plans are involved in the collective bargaining process.

Where do we stand today? Career employees now retiring—who are subject to the Fair Labor Standards Act—will leave with a minimum of 90 percent of the after-tax income enjoyed during their highest paid years of work. This percentage decreases steadily as we go up the compensation ladder.

As to those of our more than 5,000 annuitants who left some years ago, the company makes an out-of-the-till payment to bring their retirement income up to a more reasonable relationship to current retirements.

The objective of this hearing is the laudable one of exploring ways and means of extending retirement plans to those who do not now enjoy these benefits.

From my experience in our company, I believe that the prime way of continuing the outstanding growth which has occurred in this area is through maintaining a favorable climate for such growth undiscouraged by Government. Our tax laws, setting up the standards for pension, profit-sharing, and stock bonus programs, were established in 1942. They have been amended slightly from time to time but the Congress has always supported the policy of providing tax incentives under which such plans can be installed.

We now have before us the January 1965 report on "Public Policy and Private Pension Programs." Briefly this report recommends that private retirement programs will not qualify unless they meet the following:

1. Full vesting will be mandatory after 20 years.
2. Past service liabilities must be funded over not less than 30 years.
3. Similar plans will be required for all classes of employees.
4. Employees must be covered after 3 instead of 5 years of service.
5. There shall be a dollar ceiling on contributions and benefits for employees.
6. Investments by retirement funds in employer securities should be limited to 10 percent of the fund.
7. The tax laws should be changed in certain respects which have been submitted to and rejected by Congress in the past.

Advance word on this report was published in a variety of newsletters, magazines, and newspaper columns; and the tenor of these articles was to cause alarm in business about the possibility of increased costs and changes, which, if enacted, could undermine the provisions of present plans, and inhibit the inception of new plans.

Now that the report is out, I am glad to say that I believe it is wise from time to time to examine this important area in our economy. The data on growth of private plans, the coverage achieved, and the conclusions of the President's Committee that such plans "should continue as a major element in the Nation's total retirement security program" together give great hope for future growth and coverage of these plans.

We are in complete agreement with any policies which will, in fact, continue that growth. However, we believe that most of the recommendations in the report, if adopted, would impede the growth of these plans.

The basic tax laws under which private plans have prospered were passed almost 25 years ago. Under these laws the Congress established reasonable but hard and fast rules under which private enterprise could use the tax incentives created to foster the socially desirable objective. The most important of all these rules was the plans must not discriminate in favor of supervisory of highly paid employees. This is a reasonable and proper concept and plans have flourished and will continue to do so under these rules. The Congress has supported these concepts consistently throughout the years.

The Pension Trust Division of the Internal Revenue Service does a top job in being helpful, fair and prompt. A continuation of this situation, is, I believe, the very best way to achieve continued growth of private retirement security programs—the common goal of Government, labor, and business.

We come then to the persistent attempts to move into the area of imposing governmental edicts—practically all of which increase costs—into the details of retirement plans rather than letting competition and free collective bargaining do the job.

Such suggestions are made in this report and they bear a great deal of smilarity to suggestions which have been previously aired in the Congress and turned down—and these suggestions usually involve erosion of what I call a good retirement program climate.

For example, in 1942, there were hearings before the Ways and Means Committee on this subject. Mr. Randolph Paul, then special assistant to the Secretary of the Treasury, suggested that there be complete vesting of employee benefits and that an ultimate limit to a pension be fixed at $7,500 per year. Both of these suggestions were rejected by Congress.

In light of history since that time, I think you can agree that the adoption of either of these points would have inhibited the growth of plans to the extent that we could not today read the fine record we have pointed out in the report.

In 1953 I was in Washington, working with Mr. Colin Stam and the members of the Senate Finance Committee. At that time, so-called reform proposals were suggested by the Treasury but once again were rejected by the committees of Congress.

In 1960, when the Keogh-Smathers bill, H.R. 10, was under consideration, still another attempt was made by the Treasury to saddle retirement plans with incentive debilitating changes. And again, Congress stopped these.

Exactly 2 years ago today, on March 4, 1963, I had the privilege of appearing before the Ways and Means Committee to testify against the proposed elimination of the present capital-gains treatment on lump-sum distributions from qualified plans and the substitution therefor of an averaging device. We are advised that the Ways and Means Committee concurred with industry's view by a 25-to-0 vote.

I think the most dramatic illustration of the effect of imposing legislative standards into the details of retirement plans can be found in what has happened under the Keogh-Smathers bill, H.R. 10. This law imposes strict rules as to eligibility—no more than 3 years—full vesting and a low ceiling on the amount that can be contributed, in the case of retirement plans for the self-employed.

All of these requirements are reminiscent of what is being suggested in the report to the President with respect to retirement plans in general.

Yet, although the Keogh-Smathers law has been in effect for 2 years, only 15,000 persons have been covered whereas the Treasury Department estimated that 185,000 persons would be covered in the first year alone.

I would be willing to predict that, as long as these conditions obtain, coverage under the Keogh-Smathers law will be negligible. It is interesting to note that Congressman Keogh has already introduced a bill to raise the limits on the amounts that can be contributed to such plans.

So now, with this history, we have before us the current report on retirement programs. While this report is temperate in many ways, it is specific in its recommendations in some very important areas.

The report recommends amendment of the Internal Revenue Code to require that, in order to qualify, plans must provide that 50 percent of the benefits would be vested at 15 years of service and 100 percent vested at 20 years of service—regardless of the age of the participant.

The report also states that past service costs should be funded fully over a period approximating the average worklife of employees but not more than 30 years.

These items would be of little concern to Standard Oil Co. of California, because we are fully funded and our vesting schedule approximates the suggestion of the committee.

But these recommendations could have a serious effect on other companies, especially small ones. These items influence costs directly and, therefore, inhibit the establishment of new plans and the improvement of existing ones. More importantly, however, they interfere with arriving at decisions through the operation of competitive pressures and the collective-bargaining process.

Then we have the most serious and damaging recommendations in the fields of tax policy under the Internal Revenue Code. One says that the option to cover only certain groups of employees should be eliminated, unless there is a showing of special circumstances. Here again this would not affect my company but it probably would have made impossible the negotiation and setting up of good plans for employees in some of our partially owned affiliates.

In my opinion, this proposal, if enacted, would seriously distort the employer-employee relationships. I wholeheartedly subscribe to the words of Mr. Henry Ford II, contained in the addendum to the report by the President's Advisory Committee on Labor-Management Policy:

> The suggestion for changing the present Treasury rules so as to require the application of a generally similar pension plan to all classes of employees is particularly disturbing. The suggestion may appear innocuous, but it would, in fact, introduce a distortion into the collective-bargaining process, and it also ignores the fundamental fact that a pension plan is but one part of total employee compensation. To seek to impose uniformity as to this element seems to me to be unsound. It fails to take into account the interrelationship between this and the many other elements that make up the whole, and thus to reduce needlessly the scope for adapting compensation to the differing needs, desires and circumstances of various employee groups.

Another calls for reduction of the eligibility requirement from 5 years to 3 years of service. Our stock plan has an eligibility of 5 years of service plus 35 years of age. This now would be prohibited. These eligibility requirements were set for proper industrial relations and business reasons. This plan with these requirements was supported by the signatures of union representatives under more than 40 contracts when the plan cleared Wage Stabilization procedures here in Washington in 1952.

The report further states that a limitation on contributions to pension plans or a commensurate limitation on benefits should be required. As I mentioned, we first heard about this from Mr. Randolph Paul in 1942. I feel that, had such a limitation been imposed, the entire history of private pension plans would have been different and to the detriment of all employees.

Why put limitations here when none is placed on salaries, wages, or other employee benefits? Even during World War II and the Korean conflict it was not regarded as wise to impose limits on retirement benefits. Furthermore, what limit should be placed? In 1942, $7,500 sounded high. Today it would be regarded as ridiculously low. Again, I refer you to what is already happening under the Keogh-Smathers Act.

As I indicated above, there are other recommendations in this report. I have not discussed them because many of them are of a technical nature beyond the scope of my competence. However, I am advised by technical experts that these also would have an adverse effect on the present favorable private pension plan climate.

In conclusion, I want to point out that these plans have extreme individuality, that they are voluntary, and that they involve substantial financial outlays by employers. We should not impose straitjackets on all plans to meet problems which may be applicable only to a few. Our goal should be—as it has been in the past 25 years—to encourage the greatest growth in this area and to allow as much freedom as possible in tailoring these plans to the individual cases within our present legal framework.

Thank you, Mr. Chairman.

Senator Moss. Thank you, Mr. Severance. We appreciate your testimony.

Under the Standard Oil of California plan do all of your employees participate?

Mr. Severance. Yes, Mr. Chairman, our employees come under the annuity plan immediately upon coming into service. They join the plan on their first day of employment. While I stated under our supplementary stock plan we have requirements of age and service, once having achieved this, whether one is the lowest paid man at the refinery or the president, one is then completely eligible. It is across the board.

Senator Moss. How long did you say this plan has been in effect?

Mr. Severance. Our annuity plan in a variety of forms has been in effect since 1903, and then I mentioned in 1952 we put in the supplementary plan in which the entire investment is in common stock to help protect our employees against the inflation that was evident and, therefore, deteriorating the purchasing power of the money coming from the annuity plan.

Senator Moss. Thank you. We appreciate your testifying very much.

Mr. Severance. Thank you.

Senator Moss. This now concludes the witnesses that have been asked to testify today.

The committee will resume tomorrow morning at 10 o'clock and Mr. Reynolds, the Assistant Secretary of the Department of Labor is scheduled to be our first witness in the morning.

We are in recess then until tomorrow morning at 10.

(Whereupon, at 3 p.m., the Subcommittee on Employment and Retirement Incomes of the Special Committee on Aging recessed, to reconvene at 10 a.m., Friday, March 5, 1965.)

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