

EXTENDING PRIVATE PENSION COVERAGE

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
EMPLOYMENT AND RETIREMENT INCOMES
OF THE
SPECIAL COMMITTEE ON AGING
UNITED STATES SENATE
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MARCH 5 AND 10, 1965

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FRIDAY, MARCH 5, 1965

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

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

Present: Senators Randolph and Fong.

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

Senator RANDOLPH. Good morning, ladies and gentlemen.

The second day of our hearings of the Subcommittee on Employment and Retirement Incomes of the Special Committee on Aging is ready to begin.

We have the privilege this morning of hearing James J. Reynolds the Assistant Secretary of the Department of Labor.

STATEMENT OF DANIEL PATRICK MOYNIHAN, ASSISTANT SECRETARY OF LABOR; ACCOMPANIED BY PETER HENLE, DEPUTY ASSOCIATE COMMISSIONER, BUREAU OF LABOR STATISTICS; AND FRANK V. CANTWELL, LEGISLATIVE LIAISON OFFICER, OFFICE OF LEGISLATIVE LIAISON, DEPARTMENT OF LABOR

Mr. MOYNIHAN. Mr. Chairman, good morning sir. I am Daniel P. Moynihan, Assistant Secretary of Labor on Policy Planning and Research.

Senator RANDOLPH. I am sorry. I hadn't known that you were appearing instead of Assistant Secretary Reynolds. That is why I kept looking for him.

Mr. MOYNIHAN. You will look some distance to find Secretary Reynolds. He is in Galveston, Tex. He was getting on a plane there last night when it appeared that very important developments in the longshore dispute were at hand and the possibilities of settlement were imminent and as a member of the Senate Committee on Labor, Mr. Chairman, he knew you would want him to stay where he was and do the public's business this morning.

Senator RANDOLPH. I remember your appearance before this subcommittee last year to testify on increasing employment opportunities for the elderly.

Mr. MOYNIHAN. That is right.

Senator RANDOLPH. You were very helpful.

Mr. MOYNIHAN. Mr. Chairman, I have the privilege of having with me Mr. Peter Henle and I am sure his reputation has preceded him and also Frank Cantwell of the Office of the Secretary of Labor.

Mr. Chairman, when you wrote to Secretary Wirtz asking that the Department appear on this hearing, you were kind enough to enclose a list of questions which were of special interest to you and mentioned in particular 10 questions of particular interest to the Department of Labor which you would like us to respond to.

We have prepared a statement which in sum we believe does respond to these questions and I would like now to read it to you after which we should be happy to answer any questions from you or your associates to the extent of our ability.

The focus of these hearings is the present coverage of private retirement plans and possible Federal policies aimed at extending coverage. In this connection, it might be useful for me to present a brief summary of the nature and coverage of private retirement plans now in existence.

The private retirement system has been growing rapidly and has reached the point where it constitutes a major supplement to the basic public programs for retirement security. Private retirement plans now cover an estimated 25 million employees.

Senator RANDOLPH. Mr. Moynihan, do you have knowledge as to when the first private pension plan came into existence in this country?

Mr. MOYNIHAN. I don't sir. We can get that for you. I expect the plans are of rather ancient lineage but the proportion of them is very new. In 1940 only 4 million persons were covered as against 25 million today. It has been growing at a terrific rate.

Mr. Henle, who knows all these things, says plans are known to have been in effect as early as 1875. We can say that for certain. We will soon be in the second century of retirement plans. But only since the Second World War have they grown at the rate which you are now familiar with and which is the object of your concern at these hearings.

The plans now pay annual benefits of nearly \$2¾ billion to almost 2½ million beneficiaries. Their reserves, rising at a rate of over \$5 billion annually, now total over \$75 billion.

About 90 percent of the 25 million workers under private retirement plans are covered by pension plans which provide a determinable annuity for life to qualified workers upon retirement, financed by regular contributions from the employer and, in many plans, also from the employee. The balance are covered by deferred profit-sharing plans under which contributions from the employer, hence benefits for workers upon retirement, are based upon profits.

About half of all employees in private nonfarm establishments are covered by a private retirement plan; the extent of coverage varies widely among industries. Manufacturing industries as a whole and the transportation, communications, and public utility group account for a more than proportionate share of coverage.

Only a small fraction of workers in wholesale and retail trade and in the service industries, which together have more than 21 million employees, are covered.

Almost 4 million workers are covered by multiemployer pension plans, almost all of which have been established by unions and employer groups through collective bargaining. Multiemployer pension

plans prevail in such industries as construction, motor and water transportation, coal mining, and apparel manufacturing, which are characterized by a large number of relatively small employers, a high degree of union organization, and a history of successful multiemployer collective bargaining.

The private retirement system, as we know it today, is a relatively young institution. Coverage of plans, which amounted to about 4 million workers in 1940, more than doubled by 1950, and since 1950, has more than doubled again. Assuming no basic change in the legal and economic framework, it is expected that by 1980 coverage of plans may reach 42 million, which, when matched against the projected growth in the labor force, will account for more than three out of five employees in private nonfarm establishments.

May I say here, Senator, you will note that while we have been growing at a terrific rate our projections show a slowing down as a proportion of the work force. We expect to get up to about 60 percent of employees by 1980 in nonfarm establishments. We are already at 50.

So, your concern about coverage is clearly a relevant and important one because there are limits to the expansion of this system. We are approaching the point where the rate of expansion is not anything like it has been in recent years.

Senator RANDOLPH. Is the coverage more prevalent in the manufacturing industries than in services and mining?

Mr. MOYNIHAN. Exactly, Mr. Chairman. In manufacturing industries coverage is beginning to be almost a matter you can assume. In service industries, it is nothing of the sort. Rather the opposite is the case. Although manufacturing employment has been growing this last year, it has not been growing over this past decade and seems to be a fundamental factor limiting the basic coverage of the system.

It is likely that industries characterized by large numbers of small employers and by a high rate of turnover of firms and employees will continue to represent a less than proportionate share of total coverage.

These hearings are designed to examine whether coverage under private retirement plans could be extended to a larger proportion of the working population. More specifically, the question is raised whether any change in Federal policy would be desirable to encourage wider coverage.

This hearing comes at an opportune time because only recently a Presidential committee has completed its review of public policy as it affects private retirement programs. The President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs was established by President Kennedy in March 1962, with the Secretary of Labor as Chairman.

Its membership included the Secretary of the Treasury, the Secretary of Health, Education, and Welfare, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Securities and Exchange Commission.

I might interpolate that Mr. Henle was the Chief Staff Associate to the Committee. In preparing its report, the Committee benefited by a thoughtful review of an earlier draft of its report by the President's Advisory Committee on Labor-Management Policy.

The report of the Committee was made public at the end of January of this year. In his Economic Report, President Johnson stated he was releasing the report "for consideration by unions, employers, the public, and the Congress." The discussion at these hearings will form a valuable part of the public reaction to a number of aspects of the report.

The report is a broad one, covering such topics as the relation between the public retirement system and private programs, the manpower aspects of private pension plans, their financial aspects, and the operation of the tax laws affecting these plans.

There is no need to summarize the report. Essentially, the Committee found that private pension plans constituted a major supplement to the public social security system in providing retirement security to the Nation's workers. The Committee found that a major reason for the growth of private pensions has been the encouragement such plans receive from the current Federal tax provisions.

The Committee concluded that the Nation's tax laws should continue to encourage the establishment of private pension plans. At the same time, the report indicates a concern regarding the provisions of some plans which make less certain that participants will in fact receive the retirement benefits that they expect.

In the words of the Committee:

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. Because protection will always be far from complete, private pension plans cannot be a substitute for public programs, but public policy can encourage developments which will provide supplementary retirement benefits to a growing proportion of the Nation's workers and will provide greater assurance that the promised benefits will be paid.

In a number of respects, Federal policies affect the establishment of retirement plans. Foremost among these is the operation of the Internal Revenue Code which provides several specific tax advantages to qualified plans. Employers' contributions are not taxed to employees at the time they are made but only upon distribution at a later date, when employees are normally entitled to additional favored treatment. Earnings accumulated on contributions remain free of tax until distributed.

Employers' contributions, in general, are deductible as business expenses in the year in which they are accrued or made, in contrast, nonqualified plans are subject to substantial restrictions in this respect.

The committee estimated that these present tax provisions make it possible to finance private pensions at a substantially lower cost than would be possible without this special treatment. In general, it can be said that the present tax provisions provide a 30-percent discount for employers and employees.

In other words, for tax qualified plans, the cost of financing a given pension is only 70 percent as much as it would be if the contributions to the pension fund were made by employees out of wages and if the fund's earnings were subject to tax.

The Committee did not recommend any basic change in this tax treatment but did suggest certain additional standards which a plan should be required to meet before obtaining tax qualification. In general, these standards embody provisions already adopted by the majority of private plans.

The recommendations, therefore, would change a minority of existing plans.

There were several recommendations of the Committee which deal, directly or indirectly, with the question of coverage. These are the following:

One, exclusion of temporary and transient employees: Under the present law, qualified plans may exclude not only temporary and part-time employees, but also regular employees with fewer than 5 years of service. In reviewing this question, the Committee felt that the period of 5 years was too long a time during which an employee's coverage under a plan could be deferred. The Committee recommended that this 5-year period be reduced to not more than 3 years.

The Committee felt that a 3-year period would be ample to exclude temporary and transient employees. At the present time, plans which deny coverage to an employee for more than 3 years account for less than 10 percent of the employees covered by all plans.

So, there again, you see, that the Committee's recommendation would not affect most plans, but would have, nevertheless, a very important affect on some.

Senator RANDOLPH. What do you mean by transient employees?

Mr. MOYNIHAN. That is somewhat a matter of self-definition. A transient employee is one whose intention is not to remain permanently with the firm. In some cases they would be hired with that understanding and in other cases it would not be a condition of hiring but it would be the intention of the worker.

Senator RANDOLPH. The reason I asked you that question is that Secretary Wirtz, himself, in appearing before the Senate Subcommittee on Labor indicated that we were experiencing a shift of workers in the approximate number of 300,000 every 30 days in the United States. That is, from their present employment to other employment, not even within a community but to other areas of the country.

This is a movement of workers that perhaps we have never had before. Is it true to the extent that he has indicated?

Mr. MOYNIHAN. That is certainly true.

Senator RANDOLPH. Does that raise a problem here or is it one that doesn't offer any difficulty?

Mr. MOYNIHAN. I think not, Senator, in the sense that a great many of the persons shifting jobs do so, (1) because of necessity, they would prefer to stay where they are, and (2) because economic conditions or economic advantages elsewhere induce them to change.

But, the point is that I think that the great majority of persons employed in this country regard their employment as reasonably permanent. They may recognize that they are going to change jobs several times in the course of their lives, but that they are not at that moment planning to do so. It happens, but it is not a matter of specific intention at the present time.

These definitions are always difficult and I suppose you have to say that a person who knows what a transient employee looks like will recognize one when he sees him. But nevertheless, it is a condition that can be agreed upon.

Senator RANDOLPH. Thank you.

Mr. MOYNIHAN. Two, exclusion of certain classes of employees: At the present time, qualified plans are permitted to restrict their coverage

to a specific group of employees in a given firm, such as salaried or clerical employees. After reviewing this question, the Committee found no justification for arrangements under which employers are permitted to restrict a retirement plan to such a group.

The Committee recommended a change in the law under which retirement plans would no longer be able to cover only salaried or clerical employees. However, the Committee recognized that such a rule could not be applied universally and under "special circumstances" it would be desirable to permit various modifications.

In the words of the Committee:

The Committee recognizes that there are many situations where it would be wholly impractical, if not impossible, to avoid differential treatment among groups of employees. Moreover, the Committee believes that the need for flexibility in developing retirement programs for different groups of employees should be respected where adequate reasons are shown and unjustified discrimination does not result.

Thus, a retirement plan for only salaried or only clerical employees would be justified if there were a showing, for example, that other employees prefer not to be covered or prefer to be covered under separate plans applicable to them or that differences in working conditions warrant differences in pension treatment.

Next, Senator, we come to a point that goes directly to your question about the great turnover of employment in America which is not a matter we would automatically want to limit. The aspect of flexibility and fluidity in the economy is essentially good, but the question is, Can it be managed so as not to work at a disadvantage to the employees?

In a somewhat different sense, the Committee's views regarding vesting may have some implications for coverage of private pension plans.

A vesting provision, as usually defined, guarantees to pension plan participants whose employment is terminated before becoming eligible for a retirement benefit the right to all or part of their accrued pension benefits at retirement age, regardless of their employment status at that time.

Vesting normally does not apply to all plan participants but only to those meeting specified qualifications, usually regarding length of service or age. Vesting protects the pension rights of those qualifying workers whose participation in the pension plan is terminated through layoff or discharge or, in most plans, by voluntary quits.

The Committee concluded that a "reasonable measure of vesting should be included as a requirement for a plan to qualify for favored tax treatment." The Committee did not regard this as an onerous standard since two-thirds of all plans already provide some degree of vesting.

Moreover, the Committee was careful to note that any changes in the law should provide for an adequate transition period as well as special provisions to alleviate any hardships that might be caused by an increase in cost of more than 10 percent.

While this recommendation for vesting would not require any change in the number of participants for any specific plan, it would affect coverage in one sense by increasing the proportion of participants who would become entitled to retirement benefits. This was in line with the general Committee objective that pension plans provide

greater assurance that participants will actually receive retirement income.

Again, going to your point, Mr. Chairman, in evaluating the long-range promise of the private retirement system, the Committee accepted two fundamental premises: One, that a large number of employees in private industry will not be covered by plans in the foreseeable future, not necessarily because their employers wish to withhold this benefit, but rather because many small employers cannot, individually, sustain a retirement plan.

Two, that many workers, particularly the more mobile workers, who participate in a plan or plans will never receive adequate retirement benefits through no fault of their own, of their employer, or of the individual pension plans. Although the Committee did not have the formula for overcoming these obstacles to wider coverage and protection, it did see the possibility of appropriate institutional arrangements being devised for this purpose.

One approach that merits serious study, in the view of the Committee, is an arrangement which would utilize the established machinery and recordkeeping facilities of the OASDI system, the social security system.

In summary, as you can see, one of the important considerations in the mind of the Committee was the extension of the benefits of private pension plans to a larger proportion of the work force. However, in considering ways of extending such coverage, it is important to keep in mind the essentially voluntary nature of the private retirement system.

The initiation of any pension plan rests entirely upon the decision of the employer, or in collective bargaining situations, upon the joint decision of the employer and the union concerned. The role of the Government, as in many other aspects of employee compensation and employer-employee relations, should be to provide the framework and appropriate incentives for the growth and development of good practices.

Thank you, sir.

Senator RANDOLPH. Thank you, Mr. Secretary.

You have given a statement to the subcommittee which will be valuable to those members present today who have been privileged to hear you and those on the subcommittee who will want to read the record of this hearing.

I know that you believe that the hearings come at an opportune time. You stated why. Do you wish to elaborate on that point?

Mr. MOYNIHAN. Sir, I think the general fact is that this extraordinary private retirement system has grown up in America right in front of our eyes. The vitality of this idea would surprise anyone 20 years ago. Here it is, one of the largest single sources, for example, of capital accumulation in the Nation.

I believe it has been estimated, for example, that by 1980 resources of private pension plans, which I believe are over \$75 billion today, will be \$225 billion, an extraordinary increase, a threefold increase in 15 years.

The coverage of these plans is a subject which raises two possibilities. One is, if coverage is not wide enough, we run the clear risk that there will be, as it were, a discontinuity in our social insurance

systems and our private insurance systems between those workers who are covered and who gain the advantage of this private system and those workers who are not covered. If this disparity should become too great it becomes a matter of public concern.

Secondly, unless some of the problems pointed out by the President's Committee are faced up to, we run the risk of introducing rigidities into the labor market that clearly are against the general economic interest of the country. If everyone became frozen into the first plan he got into it would have some undesirable results.

Senator RANDOLPH. Secretary Moynihan, several previous witnesses have expressed the opinion that implementation of the recommendations within the report of the President's Committee might impede the extension of private pension coverage by restricting the freedom of choice of pensions, and by forcing the adoption of certain provisions that might be considered distasteful by those making decisions on whether to establish pension plans.

Now, I am wondering how much consideration the President's Committee members gave to this possibility and is there a danger, in your opinion, that this might be the result?

Mr. MOYNIHAN. Sir, the President's Committee almost began with this concern, you might say. The Committee was very much aware of it. Certainly every recommendation was made with this fact very much in mind.

I think you would have to agree, sir, I think you would agree, that the Committee's recommendations were anything but rigid and formalistic. The Committee had very few exact provisions it was proposing, but rather it proposed general social objectives without specifying precisely in what way they should be achieved.

Any of the recommended improvements in the present system are proposed in the context of finding a way to make those improvements without restricting coverage or without inhibiting the growth of this system. There is just so much vitality and so much interest in the system that it seems to us inconceivable that we can't make the comparatively few basic changes that are proposed while at the same time maintaining the growth of the system.

I would just point out, Mr. Chairman, many of the proposals of the committee incorporate provisions which have already been adopted by a great majority of the plans, and thus really would affect only a minority. These are good provisions and have been adopted by a majority for that reason; they probably ought to be adopted by the minority for the same reason.

Mr. NORMAN. Mr. Secretary, as I understand it, you are saying that the recommendations in the President's Committee report would only affect the minority of plans, since these recommendations represent good pension practices already adopted by the majority of plans, and that for this reason implementation of these recommendations would not be a major impediment to the increase of private pension plan coverage.

Is my understanding of your answer correct?

Mr. MOYNIHAN. That would be exactly correct with regard to most of the Committee recommendations. There are some which if adopted might result in changes for all funds but these were not the major proposals being made.

For example, the provision of not permitting a fund to exclude workers beyond 3 years. Most funds don't do that anyway. Just some funds do. So your statement would be exactly correct, Mr. Norman.

Mr. NORMAN. Thank you.

Senator FONG. Mr. Moynihan, you stated that 90 percent of these pension plans are now on a fixed annuity basis?

Mr. MOYNIHAN. Yes, sir. Seventy percent of workers covered by private retirement plans belong to pension plans.

Senator FONG. I assume 10 percent of these are on a profit-sharing basis?

Mr. MOYNIHAN. That is correct.

Senator FONG. How fast is the profit-sharing type of pension plan growing? Is there a big impetus?

Mr. MOYNIHAN. I am not aware of any great change in the mix of retirement plans, Senator Fong. To use a cliché, that is a very good question, Senator, and I think we could find the answer and put it in the record if you like.

Senator FONG. Yes.

Mr. MOYNIHAN. It is my impression and Mr. Henle's impression that the proportions have been running at about the same rate. There is no trend to grow or diminish on either part. I assume we can find the answer for you.

Senator FONG. Of course, the annuity type of pension has been with us for a long time?

Mr. MOYNIHAN. Yes.

Senator FONG. And the profit-sharing type of pension is just of recent origin.

Mr. MOYNIHAN. I think you would find, Senator, that in the 1920's business management was most interested in retirement systems which would associate their employees with the profitmaking objectives of their firm. So there were such profit-sharing retirement systems established at that time.

I guess the basic answer, Senator, is that this whole system is so new that there are not many trends you could describe as historical yet.

(Mr. Moynihan subsequently submitted the following statement for the record in answer to Senator Fong:)

The coverage of profit-sharing plans has recently been growing at a faster percentage rate than that of pension plans although the latter have grown by a greater absolute amount. Between 1960 and 1963, according to Social Security Administration estimates, the coverage of profit-sharing plans increased by about 1.2 million workers while pension plan coverage increased by around 2 million. However, since less than 2½ million workers were covered by profit-sharing plans in 1960, their growth rate was about 50 percent while the growth rate of pension plans, which started from a much larger base, was only around 10 percent.

Senator FONG. Could you give us some idea as to the adequacies of the retirement benefits when you compare these two types of pension plans? Do you find that the retirement benefits accruing to the retiree under profit sharing are much larger than covered under the annuities features?

Mr. MOYNIHAN. I believe the experience is mixed, Senator. I am afraid some companies make more money than others, therefore, there are situations where it turns out distinctly to the advantage of the employee to be in a profit-sharing arrangement and others where it turns out to be distinctly to the disadvantage.

I fear that there is no one answer to that, Senator. Profit-sharing plans obviously involve risks that are not involved in the other type of plan.

Senator FONG. Of course, in a profit-sharing type of plan, if the company continues to invest 10 to 15 percent of the salary from the profits, the retiree would come out with a very large retirement, wouldn't he?

Mr. MOYNIHAN. That is exactly so. I think it is a characteristic, Senator, of the profit-sharing plans to be associated with, as it were, the salaried and managerial persons in the firm and to an extent it is simply a form by which they take their interest in the business into their retirement period.

Since the number of American firms that are very profitable is large, their pension plans can be very advantageous systems and for such management persons this would represent a return on their own investment in the company. It is a very sensible arrangement for them.

Senator FONG. Have you any opinion as to the taxability or the type of tax to be imposed upon the retirement sums on profit sharing? Did you recommend a change from the capital-tax provision to an ordinary-tax provision?

Mr. MOYNIHAN. With great respect, Senator, I would defer to our colleague from the Treasury to advise you on that.

Senator FONG. I will ask you a last question.

Give us an example of an extreme type of vesting.

Mr. MOYNIHAN. I wouldn't call it extreme because I have only just become a beneficiary of it, but the Federal Government retirement program vests benefit rights in persons who have worked in civilian service for 5 years. It happens I have just had 5 years of civilian service, plus 3 years in military service, so I can't wait to be 62 years of age, to be perfectly frank with you. But that is a rather extreme provision.

Senator FONG. What you are saying is this: That before a person can be eligible for retirement under Federal retirement that all he needs is to have 3 years of service with the Federal Government instead of 5?

Mr. MOYNIHAN. No, sir; if he has 5 years of civilian service, his pension is vested and he can begin drawing it at age 62. And if he has any military service, that will count as if he were contributing although he didn't because he was in the service.

Senator FONG. Did the committee working on pension funds recommend that service be cut down from 5 years to 3 years?

Mr. MOYNIHAN. No, sir. Let me clarify that point. The committee recommended that after a regular employee has been in employment for 3 years then he must be admitted to the pension system, not, however, to be entitled to any vested benefits. The present law permits a plan to exclude employees up to 5 years, but most plans do not do that.

In fact, plans accounting for well over 90 percent of the coverage admit new workers within 3 years. Most plans just admit you after a short period of probation.

Senator FONG. Thank you. May I ask one more question?

Senator RANDOLPH. Yes, certainly, Senator Fong.

Senator FONG. This question of vesting, which was one which was gone into by the committee that worked on this subject, do you think it referred more to the profit-sharing type of plans than to any other plan about reducing the time for vesting? I know that quite a number of private plans don't vest fully until the 10th or 20th year.

If you do leave your employment during the first 10 years, for example, you default maybe one-tenth for each year less than 10. Do you think that is more applicable to these plans?

Mr. MOYNIHAN. Senator, I don't think there was any particular distinction in the minds of the committee when they came to this problem. As you know, only 10 percent of the coverage is in profit-sharing plans. The problem of vesting is a general problem. Special recommendations regarding vesting for profit-sharing plans are included in the committee report.

Senator FONG. Thank you.

Senator RANDOLPH. Thank you Mr. Moynihan, Mr. Henle, and Mr. Cantwell.

I personally want to thank Mr. Henle because Mr. Norman says you were associated with him in the preparation of these hearings.

Mr. NORMAN. That is right, Mr. Chairman. Mr. Henle has been of terrific assistance to the Committee in preparing this study of private pensions and preparing for these hearings. The entire Department of Labor has, but especially Mr. Henle, and we want to let the record show that we do appreciate the splendid assistance they have given us.

Mr. MOYNIHAN. It is very generous for you to say that, sir, and we thank you for the privilege of appearing before you.

Senator RANDOLPH. Thank you, very much.

Mr. Lawrence Stone, please.

STATEMENT OF LAWRENCE M. STONE, TAX LEGISLATIVE COUNSEL, TREASURY DEPARTMENT

Senator RANDOLPH. Mr. Stone, we welcome your appearance before the subcommittee. You may have your statement included as read in the record and refer to it, or proceed by reading it as you desire.

Mr. STONE. Thank you, Mr. Chairman.

I am the Tax Legislative Counsel for the Treasury Department.

Senator RANDOLPH. Thank you.

Mr. STONE. The Treasury Department appreciates this opportunity to appear before your subcommittee on the very important and timely subject of private pension plans.

I am especially pleased to be here since it will give me a chance to discuss the matter of extending coverage of private pension plans in the context of the report of the President's Committee on Corporate Pension and Other Private Retirement and Welfare Programs of which Secretary of the Treasury Dillon is a member.

Two of my associates, Mr. William Gibb, who is here today, and Mr. George Zeitlin, served on the staff of the Committee.

As you know, this report considers the question of public policy and private pension programs and, in so doing, makes a number of suggestions for the improvement of the basic soundness and equitable character of private pension plans. As I will discuss in more detail,

the adoption of these recommendations would in a very real sense extend the coverage of private pension plans.

Mr. Chairman, I would now like to direct my statement to some of the specific questions you outlined in your letter to Secretary Dillon.

One, is it a wise and proper activity of the Federal Government to encourage the extension of private pension plan coverage and benefits?

Although the social security system should remain this Nation's basic retirement income program, the very nature of the system itself makes private pension plans an integral and important element of the overall retirement program. The social security system is geared to providing a basic dollar amount of retirement income to a wide range of people. The strength of the private pension program is in its ability to supplement this basic public program, particularly for workers with average and above average earnings.

For this reason, the Treasury Department believes that the Federal Government should continue to encourage the growth of the private pension program. Moreover, we believe that the existing tax benefits will continue to stimulate this growth.

Of equal importance, however, is our belief that this public support should be directed only at those plans which provide coverage and benefits on a broad and equitable basis, and not just to a favored group of employees.

In addition to encouraging the growth of the private pension program, it is also necessary for the Government to protect the public's interest in this program. The reasons for this become evident in light of the following facts:

(a) Private retirement plans represent a major element in the economic security of over 25 million workers and their families.

(b) Private retirement funds are a significant—and growing—source of economic and financial power. Their present reserves aggregate over \$75 billion and are growing at the rate of \$6.5 billion per year.

(c) The characteristics of the private pension system have an important impact on manpower in our economy.

(d) The public, each year, makes a sizable investment in the private pension program through special tax savings provided in the internal revenue laws.

Let me turn to the second question you asked the Secretary.

What advantage do private pensions offer from the standpoint of the employee? the employer? the Federal Government?

For the employee, a tax-qualified private pension plan offers a source of income after retirement; in this regard, it represents a means by which he can, in effect, spread his wages over his lifetime on a most favorable tax basis.

For the employer, a tax-qualified private pension plan offers a method by which he can defer taxation on a part of an employee's wages until after retirement, but without losing his own deduction on a current basis. It thus provides a means by which an employer can—on a favorable tax basis—reward his employees with the security of a retirement pension.

I have already discussed the advantages of the private pension program to the public as a whole—that is, as a supplement to the social security system.

You next asked: "What is the annual loss resulting from present favored tax status of private pension?"

To understand the revenue figures it is first necessary to understand the nature of the special tax treatment afforded private pension plans. It has two aspects.

Employer contributions, now at a rate of almost \$6 billion annually, are treated as tax deductible expenses of the employer for the year when the contributions are made. On the other hand, as I noted, these contributions are not taxed to the employee until he receives them—which is generally not until after retirement.

At that time, because of special tax provisions available to older people such as an extra exemption, et cetera, and the probability that the employee's income level during retirement will be reduced, the pension payments will be taxed, if at all, at substantially lower rates than if they had been taxed on a current basis during his working years.

The second aspect relates to earnings of the pension funds. These earnings, now at an annual rate of over \$2.5 billion, are not taxed when earned but, instead, are taxed to the employee when distributed, also usually after retirement.

The value of the tax deferral on both employer contributions and earnings of the fund can be measured in two ways:

(1) If it is assumed that, without the special tax treatment, the employer contributions and fund earnings would have been currently taxed to the employees as compensation, in the year when the contributions were made or the earnings realized, the annual revenue loss amounts to \$1.2 billion.

(2) If, instead, it is assumed that the contributions and earnings would have been currently taxed at the corporate level, the annual revenue loss amounts to \$3.4 billion.

These figures are more fully explained and illustrated in the report of the President's Committee.

You have asked whether this revenue loss is in nature of a tax loophole.

To the extent that the system of private pension plans fulfills the public objective of supplementing the social security program, in an adequate manner, the revenue loss may be justified as a matter of public policy. In particular, it is important that these plans provide coverage on a broad and equitable basis. When a plan does not meet this standard, the revenue loss would not seem to be a prudent investment of public funds.

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

The report of the President's Committee outlines two important avenues for broadening the coverage of private pension plans:

(a) The first is to insure that "coverage" under pension plans which qualify for special tax treatment is an actuality for employees and not an empty promise. The report outlines several specific proposals to accomplish this, including: a requirement that an employee's right to his pension become vested after a reasonable number of years; and a requirement that the employer maintain a sound level of funding to insure that moneys will be available from which to pay this pension.

(b) The second general approach for extending pension coverage is to insure that those pension plans which qualify for the special tax treatment provide for participation of the rank and file of employees on a broad scale.

Again, the report of the President's Committee makes specific recommendations to this end, including proposals to eliminate, in most cases, the option an employer now has to limit coverage to only salaried and clerical employees; to reduce the maximum waiting period for coverage from 5 to 3 years; to reduce to a more realistic level the extent to which an employer may take credit for social security benefits, and to require nondiscriminatory coverage under tax-qualified plans established by tax-exempt institutions.

Now, let me turn to the question of self-employed individuals as compared to corporate employees.

Senator RANDOLPH. Is this group of individuals growing in number?

Mr. STONE. As of 1962, there were about 7 million self-employed who could participate in the new pension plan arrangement for the self-employed people. In 1954 only 4.5 million would have been eligible.

Senator RANDOLPH. Thank you, Mr. Stone.

Mr. STONE. Mr. Chairman, your letter to Secretary Dillon posed several questions regarding the provisions under which self-employed individuals may establish and participate in pension plans with certain tax advantages. Instead of trying to answer them one by one, I would like to cover the situation in a more general manner.

The treatment of retirement savings of the self-employed raises important questions. The issues involved as to whether the self-employed should receive favored tax treatment for retirement savings are not the same as those involved in the treatment of corporate pension plans.

However, even if it were assumed that the self-employed should be granted some tax concessions in this area, any changes in the present self-employed pension provisions would, in the opinion of the Treasury Department, best be considered in the context of congressional consideration of the overall pension recommendations outlined in the report of the President's Committee.

In any event, it would clearly be undesirable to take the artificial expedient of giving "corporate status" to businesses and activities more naturally carried on in a noncorporate form.

Mr. Chairman, you have also asked for data on participation by self-employed individuals in pension plans. Because of the relatively short period that the self-employed pension provisions have been in effect, we are not able to give you any meaningful data on the extent of participation by the self-employed.

While the Internal Revenue Service has been requested to rule on many plans established by the self-employed, it can be expected that such requests do not cover all plans that may have been adopted to date, since many self-employed individuals are utilizing so-called master plans and have not, therefore, believed it necessary to submit their individual plans for Internal Revenue Service approval.

The first meaningful data will be available from information on the income tax returns filed for 1964. This is the first year for which

there was any appreciable activity under the 1962 legislation. The Internal Revenue Service has indicated that it will tabulate the information as quickly as possible.

We do, however, have the information you requested on the extent to which the special U.S. retirement bonds have been utilized by pension plans. To date, approximately \$10 million worth of these bonds have been purchased.

In summary, Mr. Chairman, the report of the President's committee contains recommendations for expanding coverage of private pension plans. The Treasury Department believes that these proposals merit public consideration and analysis.

We hope that these hearings will be the beginning of a meaningful public discussion of the important issues involved. Thank you again for the opportunity to appear before your committee.

Senator RANDOLPH. Thank you very much, Mr. Stone.

You raised several points and you have agreed also with certain witnesses who were here prior to your testimony.

Mr. Norman, would you question Mr. Stone?

Mr. NORMAN. Mr. Stone, as an attorney what would you say the constitutional justification is for the Federal Government to be in this field of private pension plans at all? Would you point to certain clauses in the Constitution as justifying Federal action in this regard?

Mr. STONE. I suppose the general provisions relating to providing for the general public welfare would be sufficient. Is that it?

Mr. NORMAN. The general welfare clause in article I, section 8?

Mr. STONE. Well, I am not a constitutional lawyer. If you would like more definite thoughts on that I would be glad to have the general counsel prepare an opinion.

Mr. NORMAN. Also, would you consider the power to tax in the same part of the Constitution, article I, section 8, as justification inasmuch as the Federal Government obviously has the power to decide what is a proper subject for taxation, what provision should be made in its tax laws to take care of certain hardships and to avoid creating new hardships. Would you believe that a justification?

Mr. STONE. I believe the courts have since ruled that reasonable exemptions or deductions that apply to broad classes of taxpayers are constitutional.

Mr. NORMAN. And also the 16th amendment under which the income tax is levied?

Mr. STONE. That is correct.

Mr. NORMAN. That would be justification for taking into consideration the need of the citizenry for retirement security? Would you consider that a justification in the Constitution?

Mr. STONE. Yes. I think there is ample constitutional support. We have no doubts as to the constitutionality.

Mr. NORMAN. Mr. Stone, you have kindly offered to get us an opinion on this. I am reluctant to ask this, but it would be very helpful to the subcommittee in understanding why the Federal Government is in this field, if you would get that for us.

Mr. STONE. We will do that.

Mr. NORMAN. We would certainly appreciate it. Thank you.

(The information referred to follows:)

THE GENERAL COUNSEL OF THE TREASURY,
Washington, D. C., March 22, 1965.

THE CONSTITUTIONAL BASIS FOR PROVISIONS OF THE INTERNAL REVENUE CODE OF 1954 PERMITTING DEDUCTIONS FOR PAYMENTS TO QUALIFIED PENSION PLANS

A question has been raised as to the constitutional basis for special tax treatment in the area of private pension programs. A review of the case law, pertinent statutory material and commentary on the subject leads to the conclusion that the constitutional basis for such treatment is found in the power of Congress to lay and collect taxes to provide for the general welfare, as provided in article 1, section 8, clause 1, of the U.S. Constitution. The following discussion seeks to amplify that conclusion.

The power of Congress to tax in order to provide for the general welfare is sweeping. *Barclay & Co. v. Edwards* (267 U.S. 442 (1924)); *Magnano Co. v. Hamilton* (292 U.S. 40 (1934)); *James v. United States* (366 U.S. 213 (1961)). In *Brushaber v. Union Pacific R.R.* (240 U.S. 1, 12 (1916)) the court described it as "exhaustive." The taxing power may be utilized for a wide variety of purposes, including, for instance, the purpose of strictly regulating narcotics traffic,¹ of fostering Western Hemisphere trade corporations,² of protecting a fledgling industry from foreign competition,³ and of providing retirement security for employees.⁴

A necessary incident to the taxing power is the power to create deductions, exclusions or other types of preferences, subject to the due process requirement of reasonableness.⁵ This concomitant power is as extensive as the taxing power and may be utilized to accomplish the same purposes.⁶ Since a tax levy to finance a retirement program is clearly within the taxing power, a deduction arrangement designed to further that end is also lawful and proper. There is no constitutional requirement that this valid legislative objective be accomplished solely by establishing a retirement fund from tax moneys. A tax incentive to encourage private pension plans is a reasonable means to supplement the retirement security scheme.

The existence of such private pension plans also affords an incentive for early retirement, thus multiplying the number of available jobs, a result clearly favorable to the congressional policy aimed at decreasing unemployment.

The contributing employer's deduction, however, is justifiable on another ground. It is plainly a reasonable exercise of legislative judgment to consider the contributions of an employer to a qualified pension plan as an ordinary and legitimate business expense. Although the source of the employer's deduction is neither 26 U.S.C. 162 (trade or business expenses) nor 26 U.S.C. 212 (expenses for the production of income), the Code indicates that the theory of the deduction is the same. (26 U.S.C. 404(a); Treas. Reg. 1.404(b).) There is no appreciable logical difference between employee wages and salaries and the additional compensation of retirement security. Therefore, deductions under 26 U.S.C. 404 are constitutional to the same extent that other business expenses are.

In standard tax theory and practice any amount deducted by an employer in his tax return as compensation to employees is attributed to them as income in the same year in which the deduction was taken or in the following year. The private pension plan sections of the Internal Revenue Code (26 U.S.C. 401-404) create an exception by deferring the attributable income until their retirement.⁷ Unquestionably, the determination by Congress, that the proper time to impose a tax is when the pensions are actually received by the employees concerned, is a reasonable and fair exercise of legislative judgment and one within its power to make.

¹ *Nigro v. United States* (276 U.S. 332 (1928)).

² 26 U.S.C. 921, 922.

³ *Hampton & Co. v. United States* (276 U.S. 394 (1928)).

⁴ 42 U.S.C., ch. 7. *Carmichael v. Southern Coal & Coke Co.* (301 U.S. 495 (1937)); *Stewart Machine Co. v. Davis* (301 U.S. 548, 591 (1937)).

⁵ *Flemming v. Nestor* (363 U.S. 603 (1960)); *Burnet v. Wells* (289 U.S. 670 (1933)); *Smart v. United States* (222 F. Supp. 65 (S.D.N.Y., 1963)).

⁶ "Congress has the power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax." *Helvering v. Independent Life Ins. Co.* (292 U.S. 371, 381 (1934)). See also *Commissioner v. Sullivan* (356 U.S. 27 (1958)).

⁷ Stanley and Killicullen, *The Federal Income Tax*, 192 (4th ed. 1961).

The 16th amendment has no particular relevance in this context inasmuch as it confers no new power on Congress, but, in effect, merely designates income taxes as indirect taxes.⁸

It is accordingly the view of this Department that the provisions in the Internal Revenue Code which deal with private pension plans have a sound constitutional foundation.

FRED B. SMITH,
Acting General Counsel.

Senator RANDOLPH. Thank you very much, Mr. Stone.

(The following letter was subsequently received from Mr. Stone in answer to a question presented to him after the hearing.)

OFFICE OF THE SECRETARY OF THE TREASURY,
Washington, March 29, 1965.

HON. JENNINGS RANDOLPH,
Chairman, Subcommittee on Employment and Retirement Income, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is in response to the request of Mr. Norman for information as to the revenue implications of removing the provision contained in the Self-Employed Individual Tax Retirement Act of 1962 (H.R. 10) which limits the deduction for amounts contributed to a qualified plan by a self-employed individual to 50 percent of the amount contributed. In 1963 this Department estimated that H.R. 10, as enacted, involved an annual revenue loss of \$180 million. We further estimated at that time that removal of the 50-percent limitation would increase the annual revenue loss to the vicinity of \$300 million.

I hope that this letter will be of help to the subcommittee.

Sincerely yours,

LAWRENCE M. STONE,
Tax Legislative Counsel.

Senator RANDOLPH. We will have the privilege now of hearing from Mr. Shoemaker and Mr. Lesser.

**STATEMENT OF RICHARD E. SHOEMAKER, ASSISTANT DIRECTOR,
DEPARTMENT OF SOCIAL SECURITY, AFL-CIO, AND LEONARD
LESSER, ASSISTANT TO THE PRESIDENT OF THE INDUSTRIAL
UNION DEPARTMENT, AFL-CIO**

Senator RANDOLPH. Mr. Shoemaker, we are very happy to have you and Mr. Lesser.

Will you identify yourselves for our record so that our audience may know. The subcommittee does have that knowledge, but I feel the audience oftentimes does not have the statement which indicates the affiliation of the witness. We ask that you do that, sir.

Mr. SHOEMAKER. Thank you very much, Senator.

I am Richard Shoemaker, assistant director of the Social Security Department of the AFL-CIO. With me is Mr. Leonard Lesser, who is assistant to the president of the Industrial Union Department of the AFL-CIO.

I do want to say, Senator, we are very glad to be before you. I think that you submitted to us a number of questions on which you asked our comment. As a matter of fact many of these questions dealt with the President's report which is now under very serious study and consideration by the AFL-CIO Social Security Committee and, of course, the executive council.

We find that for many of these questions, we are not prepared at this time to offer a comment. As I say we are grateful for the opportunity to appear before this subcommittee to express our views in regard to some of the emerging problems that are associated with the

⁸ *Stanton v. Baltin Min. Co.* (240 U.S. 103, 112 (1916)).

rapid growth of private pension plans. The AFL-CIO shares the concern of the members of this subcommittee that the retirement income of the aged is the concern, not only of the aged, themselves, but all Americans. Certainly, a substantial part of the problem of poverty in America is the relatively meager incomes of a great proportion of our older workers, or retired workers perhaps.

We have come a long way, indeed, since the *Inland Steel* decision in 1949 which established the right of employees to bargain with their employer in regard to pensions. At that time, the number of employees covered by private pension plans numbered less than 9 million. Today, there are about 25 million employees under such plans. We believe the major impetus in this development came from collective bargaining by our affiliated national and international unions.

We are proud of our achievements, but, through actual experience, we are becoming increasingly aware that if pension plans are to fulfill the social function of providing an adequate income for retired workers; if, in fact, they are to measure up to the expectations of the beneficiaries, some improvements may be necessary.

We are aware, of course, that there are many people who would not accept the proposition that private pension plans should serve a social purpose. To some, pensions serve only some corporate purpose or some concept of company personnel policy. We cannot accept this philosophy. If, indeed, this were their only purpose, Congress would hardly have bestowed upon such plans favored tax treatment involving revenue loss in excess of \$1 billion annually.

We have referred to some problems that have emerged in regard to private pension plans which, perhaps, may indicate attention should be directed toward some of their limitations as well as to their achievements. It would, indeed, be somewhat of an anomaly that in a field so characterized by rapid growth that there would not, in fact, be problems. With growth, there are invariably growing pains. Some of the growing pains include:

One, a substantial number of people covered by private pension plans never qualify for benefits because of their failure to meet the eligibility requirements of their plan.

Two, there are some real questions as to the degree of protection beneficiaries have in their accrued rights to a private pension where an employer goes bankrupt, where there is a merger or where there is a shutdown of the plant of a multiplant employer.

Three, there are real problems of extending coverage to small employers and to employers in certain highly competitive industries such as wholesale and retail trade, services, and agriculture.

Four, there are special problems in extending coverage to employers whose work force is composed of older workers.

Five, there are problems associated with the investment of huge pension funds now amounting to about \$75 billion and which are expected to grow to \$225 billion by 1980. Associated with this is the problem of the concentration of social and economic power.

These are proper areas of concern. Solutions to some of these problems can be facilitated by Federal action. Other problems may require action through collective bargaining. Certainly, many of the problems would be minimized and the need for action would be reduced, if not eliminated, were OASDI benefits under social security sufficient to provide a really adequate level of income upon retirement.

Social security old-age benefits are portable as between different employers. Coverage is close to universal. Employees do not lose their social security credits because of bankruptcies, mergers, or plant shut-downs. The tax cost of social security is evenly spread between all employers whether they be large or small, whether they be in the service or in the manufacturing industry or whether their employees are young or old.

With a truly adequate basic protection under social security, private pension plans, with their inherent advantage of being completely flexible in their benefit provisions, could supplement gaps in the basic public program and provide benefits to meet special conditions and circumstances. Early retirement provisions to meet the problem of unemployment in the mass production industries is an example of the adaptability of private plans to meet such special conditions.

We also realize that even with an adequate social security program, which could provide a basic coverage for all, there still would be need for supplementary private pension plans for those industries and occupations which had pay scales well above average.

The problem of protecting beneficiaries from the possible loss of their pensions because their employer goes bankrupt is a pressing one. A study of plan terminations by the U.S. Department of Health, Education, and Welfare which appears in the December 1963 issue of the Social Security Bulletin indicates that over a 10-month period, retirement protection for 7,000 workers was discontinued.

We submit that it would be entirely feasible and desirable to have a Federal program of insurance which could insure each plan in an amount equal to the unfunded liability of the plan. In this way, if a company went bankrupt there would be sufficient assets, together with insurance, to fully meet the liabilities for future benefits for all employees. The premium for such an insurance program would be quite modest in relation to the total contributions currently being made to private pension plans.

Employer contributions to pension plans, like wages, are an obligation of the employer because of work performed. We feel legislative action is needed to clarify the status of these pension obligations by amending the bankruptcy laws to provide that these obligations should be accorded the same priority as wages in the event of bankruptcy.

We are aware, of course, that the subject matter of these hearings is "Federal policies to encourage businesses to provide pension coverage of those who are not covered." However, this is no easy task, and we feel we would be remiss in our responsibility if we did not, in fact, indicate to the members of this subcommittee our interest in liberalizing social security as the most feasible way of providing an adequate retirement income to the millions of Americans whose outlook for coverage under a private plan is, at this time, at least, quite remote.

We also feel a responsibility to indicate our concern about the need to provide a greater degree of security to beneficiaries where companies go bankrupt or when plants shut down.

Indeed, it does appear to us that the problem of extending coverage to small employers in the retail and wholesale industry, the service industry and, particularly, the agricultural industry is quite formidable under the present system of tax exemption for the cost and interest on funded reserves of a pension plan.

Many of such business operations are quite marginal. Many just cannot afford a pension plan. Employee turnover is substantially higher in such establishments than in manufacturing. A special labor force report on the "Job Tenure of American Workers, January 1963" which appeared in the October 1963 issue of the *Monthly Labor Review* shows the median job tenure of male laborers over 45 years in wholesale and retail trade as being but 6.9 years. For younger male laborers 25 to 44 years of age in the same industry, the median length of time on the job was but 2.5 years.

It would appear, therefore, that for the single employer in wholesale and retail trade, a very liberal vesting provision would be necessary if the pension plan were to be of any appreciable value at all to the employees. This, of course, raises the cost.

Other reasons why costs are high for the single small employer in competitive industries is that the cost of administration per covered employee is more for a small plan than for a large one. Funding the unfunded liability over a period of, say 30 years, may give adequate protection to the employee of an industrial giant while a like period for a small plan is highly risky in relation to the reliability of fulfilling the pension expectations of the covered workers. Amortizing the unfunded liability over shorter periods of time also increases cost.

Through free voluntary collective bargaining, the labor organizations have made considerable progress in extending the coverage of pension plans to small employers in wholesale and retail trades in the garment industry, in construction, and to a lesser extent in the service industry.

Very little progress has been made in agriculture. We refer here to the multiemployer plans in these industries which meet many of the problems associated with the development of a sound pension program. Through creating one large plan instead of a multitude of small ones, administration costs are substantially reduced.

While the mortality of individual small firms may be high, the industry as a whole is quite stable and as unlikely to cease to exist as a giant corporation. While the rate of turnover associated with the individual employer is high, there is a considerable degree of tenure within the industry.

Such plans as have been developed by the International Ladies' Garment Workers Union, the Amalgamated Clothing Workers, the building trades, and the Retail Clerks International Union covering a multitude of several employers appears to be one answer, at least, to the problem of extending coverage. A strong union which negotiates with the many small employers provides a common tie which makes such arrangements feasible. While there may be multiemployer plans which have been sponsored unilaterally by employer associations, we believe the extent of such arrangements are quite limited.

Also worthy of mention are pooled plans like the "Toledo plan" where a number of employers of different industries pooled their contributions to establish a multiemployer plan. Here the United Automobile Workers provided a strong impetus toward the development of the program. The International Association of Machinists, the Operating Engineers, and the International Brotherhood of Electrical Workers have established multiemployer plans on a national level.

Perhaps it is through policies to stimulate and encourage the formation of multiemployer plans on either a local or national level that the Federal Government can make a contribution toward the goal of extending coverage under private pension plans to those who do not now have such protection.

We were requested by Chairman Randolph to answer certain questions submitted to us in advance of the hearings. Our statement, we believe, answers questions 1 and 8. These questions were:

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?

And—

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

In regard to question No. 2:

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

We have indicated the advantage of private pension plans to both employer and employee in providing a highly flexible method of providing retirement income suited to different situations.

However, it should be pointed out that the interest of the employer in providing an incentive to the employee to stay with one firm does not necessarily coincide with the interests of the employee in seeking a better job with another employer. The interest of the employer in retaining employees is probably in conflict with social and governmental goals of reducing impediments to mobility of the labor force.

In regard to question No. 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?

The great preponderance of pension trusts are honestly administered to provide for the future retirement income of older workers.

There are cases in which the motives of the employer appears to have been that of utilizing a tax loophole to amass a fund which could be used for corporate purposes. A number of such cases involving the Rapid-American Corp., "The Sixty Trust" of the Textron Corp., the Springfield, Mass., Republican were reported in the October 31, 1964, issue of the New Republic. To these we would like to add the story concerning certain financial manipulations by the Genesco Corp. as reported in the New York Times for May 20, 1964, as well as in the Wall Street Journal of the same date. The full text of the New York Times article appears in the appendix to our statement.

Senator RANDOLPH. May I ask you at that point, has there been any court action?

Mr. SHOEMAKER. I believe there has. They do refer in the article to a case that was coming up.

We are concerned that there may well be more of such use of "tax free" funds for corporate purposes than has come to light. Enforcement of standards of prudence in the investment of pension funds is an area which may well require Federal action.

In regard to the rest of the questions submitted to us for comment, several of these refer to the recently released report to the President on private employee retirement plans, "Public Policy and Private Pension Programs." We are seriously studying this report and its many recommendations, but we would like to defer comment upon the report until our social security committee and the AFL-CIO Executive Council have had time to formulate our position on many of its important recommendations. Other questions submitted to us can, we feel, be answered better by others scheduled to appear in these hearings.

That is the conclusion of my statement.

Senator RANDOLPH. On page 113 of your statement, you say:

Perhaps it is through policies to stimulate and encourage the formation of multiemployer plans on either a local or national level that the Federal Government can make a contribution toward the goal of extending coverage under private pension plans to those who do not now have such protection.

Would you please spell out in some detail just what is in your mind in the way of Federal action to stimulate and encourage these multi-employer plans?

Mr. SHOEMAKER. Senator Randolph, this is one of the items we are considering and have under study. Perhaps we could submit at a later date some ideas in more detail.

Senator RANDOLPH. Mr. Lesser.

Mr. LESSER. If I may for a moment, Senator, I agree with Mr. Shoemaker that this is an area where we really have not spelled out in full detail the things that need to be done, but just let me indicate some of the experiences we have had.

At the present time the industrial union department has been holding a series of meetings with some of the technical people in our affiliated unions, with representatives of the insurance industry and with representatives of some of the banks. We are trying to develop a mechanism through which employers, particularly of small numbers of employees, who bargain with any one of the unions affiliated with the industrial union department, could establish pension plans.

There are some 69 unions affiliated which would have a mechanism to provide pension coverage. This would involve the pooling of some experience, and there are some questions, I raise them only as questions, because we have not gotten final opinions as of this point, as to the flexibility of existing regulations under the Internal Revenue Code to permit the pooling of experiences.

I can't say at this point whether any change is needed. I think that it is through the development of some such mechanism that the coverage of small groups can best be effectuated.

I know that a proposal was made yesterday by Mr. Bernstein for the establishment of a national small group plan which would be open to anybody. This would be another way.

Senator RANDOLPH. Mr. Shoemaker, you have indicated that the labor unions, those engaged in the field of collective bargaining, have been a very considerable force in the expansion of private pension plan coverage. There hasn't been any pressure, there has just been counseling, give and take, between management and labor.

Is that a correct statement?

Mr. SHOEMAKER. I think that is a substantially correct statement insofar as many of the multiemployer plans are concerned.

Senator RANDOLPH. There have been at times those who have indicated or intimated programs were brought into being under compulsion and I don't believe management has entered into these plans under that sort of duress.

Do you agree with me?

Mr. SHOEMAKER. In general, I would think in multiemployer situations, in many cases at least, a substantial number of employers wish to provide some degree of stability into the labor force and this is one of their motivations as well as the higher motivation of wishing to provide a retirement income for their labor force.

Senator RANDOLPH. It has been in the interest not only of pension coverage for the worker, but also of productivity, and also morale and good relations between all the elements within a company, management and labor; is that correct?

Mr. SHOEMAKER. I would say that is substantially true. I don't think it would be true in all instances, I am sure.

Senator RANDOLPH. Do you have further comment, Mr. Lesser?

Mr. LESSER. No. I think more recently this is certainly the situation. If we go back, of course, before the *Inland Steel* decision which established that the whole subject of pension plans was a proper subject for collective bargaining, until that decision, there was great resistance on the part of employers. Since then I think there has been acceptance of the general principle. Of course, there are always differences as to some of the details.

Senator RANDOLPH. You would say, then, that the private pension system has proved itself in industry and that management as well as labor recognize the advantages of private pensions. Is this correct?

Mr. LESSER. I would say, yes; definitely.

Senator RANDOLPH. Thank you, Mr. Shoemaker. Thank you, Mr. Lesser.

Mr. Shepherd and Mr. Lindberg.

STATEMENTS OF PEARCE SHEPHERD, CHAIRMAN, SPECIAL COMMITTEE ON PRIVATE PENSION PLANS, CHAMBER OF COMMERCE OF THE UNITED STATES; AND JEAN M. LINDBERG, MEMBER, SPECIAL COMMITTEE ON PRIVATE PENSION PLANS, CHAMBER OF COMMERCE OF THE UNITED STATES

Senator RANDOLPH. Will you also identify yourselves as to organization as well as name for our audience?

Mr. SHEPHERD. I will be glad to, Senator.

My name is Pearce Shepherd. I am chairman of the Special Committee on Private Pension Plans of the Chamber of Commerce of the United States and a fellow of the Society of Actuaries.

Appearing with me is Mr. Jean M. Lindberg, a member of the special committee on private pension plans. Mr. Lindberg is an authority on private retirement programs with a special competence in the field of trusteed pension plans. He is vice president of the Chase Manhattan Bank.

I am senior vice president and chief actuary of the Prudential Insurance Co. of America. We are representing the Chamber of Commerce of the United States.

We appreciate the privilege of appearing before this distinguished subcommittee and this opportunity to state the national chamber's position on the subject of this hearing.

It is our desire to respond to the questions for which you have requested answers and we will for those questions concerning matters on which the national chamber has policy positions. I want to say that the national chamber is completely in accord with the objective of expanding private plan coverage. When we speak of pension plans, we mean to include, where appropriate, profit-sharing plans, too.

The national chamber is encouraging employers to:

1. Give to employees a clear explanation of company pension plan provisions, employee rights thereunder, and the extent of employer obligations and responsibilities.

2. Work out programs of funding which can reasonably be expected to provide for the plan benefits.

3. Make appropriate use of qualified actuaries, lawyers, and accountants.

4. Make appropriate use of the services and facilities of qualified trustees or insurance companies.

Some principles that we believe are basic to an understanding of the problems we are dealing with are:

First, employees should be encouraged and aided by all proper means to provide money income for their retirement years by savings of all kinds. Pension funds created by employers and placed in securities and other assets of productive enterprises and other economically sound investments are an important supplement to individual savings as well as a necessary support for our economy.

Second, the social security system for making payments to retired people should maintain the objective of providing a "floor of protection" against want and destitution at a cost which does not impose an unfair burden on those who are taxed.

Our answers to the questions asked by this subcommittee document the reasons for our belief that the objective of extending pension plan coverage can best be achieved by employer-employee actions, freely arrived at within a favorable Government climate.

The reasons are also documented for our belief that the further governmental restrictions on private pension plans proposed by the President's Cabinet Committee and others would hamper instead of foster the growth and effectiveness of private pension plans.

Mr. Lindberg will now comment on our answers to those questions to which you have asked us to respond and which we believe fundamental to the objective of extending pension plan coverage.

Senator RANDOLPH. Thank you, Mr. Shepherd.

Mr. Lindberg, we are very happy to have you speak at this time.

Mr. LINDBERG. Thank you, Senator.

The first of your questions on which you asked us to express a view and on which the chamber has expressed itself is:

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?

It is in the interest of all citizens that individuals be as financially independent as possible during their retirement years. Therefore, we believe it is wise for the Federal Government to provide a climate

which encourages employers to establish private pension and profit-sharing plans, and encourage employee participation.

Assuming a continuing and improving Government climate for private pension plans and acknowledging the strong support of the private pension plan concept by organized business and labor, the numbers and effectiveness of such plans will continue to grow. The fact of this growth will assure a continuing increase in the total amount of private pension plan income to retired people, as more and more become entitled to benefits under private pension plans.

Private pension plans are a most equitable means of providing additional economic security to individuals. Under the private pension plan system, the employee may seek employment in those establishments which provide the kind of compensation arrangements and working conditions—including the type of retirement program—which he thinks best for himself. In other words, the kind of a pension program an employer has is one of the factors evaluated by the employee in choosing his job.

Employer implementation of the principles outlined in the private pension plan action program of the national chamber and the proper utilization of presently existing Federal and State laws, decisions and regulations applicable to private pension plans will and are resulting in the extension of soundly based private pension plan coverage and a consequent increase in the total amount of pension plan income received in retirement.

The Federal Government should not set too rigid standards which a private pension plan must meet to qualify for prescribed tax treatment. One reason is that a pension plan is one segment of the total cost of operating a business. An employer's profit and loss statement is an implacable taskmaster. Government standards cannot change economic facts and would impede progress toward the objective of pension plan coverage for the employees of large numbers of small- and medium-sized businesses.

The second question was:

What advantages do private pensions offer from the standpoint of the employee? The employer? The Federal Government?

A private pension plan is attractive to an employee because it assures him of greater independence in his retirement years. He is assured of greater freedom of choice as to how he lives and spends his money. Pension plans help employers to maintain an efficient work force with good morale and help to assure an effective market for goods and services among the retired population. Private pension plans advance the Government's objective of a growing, yet stable, private enterprise type of economy for the benefit of all citizens.

Another question was:

Is the revenue loss more in the nature of a "tax loophole" 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?

We reject the implication in the report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs that the tax treatment accorded private pension plans constituted a "tax loophole."

Pension plan costs to the employer are not different from wage and other business costs. They are, undeniably, a legitimate business expense. The tax to employees is deferred, not eliminated.

Elimination of the deduction on employer contributions to private pension plans will either increase the cost to the employer or reduce or eliminate benefits to the employee.

In addition, elimination of the tax exemption of the income to qualified pension plan funds can only serve to increase costs to the employer or to reduce employee benefits.

The tax treatment accorded employer contributions to private pension plans and the income on pension funds and the tax deferment granted to the employees is a sound investment for the country as a whole. President Johnson and prior administrations again and again have stressed the fundamental role of private enterprise in the United States, and Congress has had the wisdom to enact laws designed to encourage private pension plans as a desirable voluntary supplement to the social security retirement program.

Private pension plans will aid ever-increasing numbers of retired people to be more independent financially with a minimum infringement on the freedom of any individual. We submit that this is the proper path to follow toward a strong and stable economy within a great and free society.

Another question was:

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

The best possible Government action would encourage a climate of certainty rather than uncertainty, a climate in which Government unequivocally recognizes and encourages the private sector's role in aiding employees to build financial security for themselves.

Certain of the present regulations require information which is burdensome, especially to the smaller employer. This applies to some of the requirements of the Federal Welfare and Pension Plan Disclosure Act and to the volume of annual reporting for internal revenue purposes. These regulations should be examined, and only such information as can be proved to be necessary and useful should be required.

Another question was:

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?

Among the special problems involving employment practices for agricultural workers are—

- (a) The seasonal nature inherent in agriculture.
- (b) Migratory, unskilled, and semiskilled labor which is not only highly transient among farm employers but which for many of the workers is a temporary form of employment until a more steady occupation can be found.
- (c) A substantial part of the compensation of farmworkers is in a form other than direct wages and, therefore, would have to be translated into wage equivalents in some uniform method in order to form a basis for the application of a retirement benefit formula.

Governmental statistics indicate the continuing reduction in the number of small farms and a continuing increase in the size of large ones. One of the main reasons for this is the greater economy of operation inherent in a large farm through the use of labor-saving devices and utilization of advanced agricultural techniques. Federal imposition of pension coverage requirements on farm employees might possibly hasten the demise of many of the small and marginal farm operations, thereby throwing more unskilled workers into the labor market and possibly into the ranks of the unemployed and unemployable.

In turn, this would place a greater burden on the rest of the population to provide for the support of a nonproductive group. Any Government action taken at this time to require pension coverage of farm employees would be harmful.

We believe that National, State, and local agricultural organizations should be encouraged to give consideration to the retirement problems of farm employees and to advise their memberships as to the most practical solutions available to meet their unique requirements.

Another question was:

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?

Coverage under this act is far short of that which was originally predicted by the U.S. Treasury Department in the hearings prior to its enactment. The only source of accurate statistics on actual coverage is the pension section of the Internal Revenue Service.

However, an educated guess might indicate national coverage of not more than 10,000 or 15,000 individuals after 2 years of operation as compared with the first-year estimates of the Treasury Department and others ranging upward of 100,000 out of the approximately 7 million of self-employed persons, who might be able to take advantage of this act.

Another question was:

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

The U.S. Treasury Department is the only source of accurate data regarding the amount of special bonds purchased through any given date. Again, an educated guess would indicate that the figure to date for the entire United States is not much more than \$5 million.

However, today we heard the spokesman for the IRS indicate that this had reached a \$10 million figure.

Another question was:

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?

Professional service corporations and associations, formed or considered as a means of obtaining pension plan benefits now unavailable, have for all practical purposes been ruled out by final Treasury regulation. We believe this to be a distortion of legislative intent and should be corrected to permit self-employed professionals who are bona fide members of professional associations to participate in qualified pension programs of the association.

Another question was :

What would be the effect upon extension of 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?

This would be a serious deterrent to further growth of funded private pension plans. The cost consequences of this recommendation could be substantial to many employers. As a result, companies may be tempted, or even forced to adopt an unfunded or nonqualified arrangement for limited groups instead of continuing their present qualified plans or adopting new ones.

The Treasury has long established prohibitions against discrimination as to coverage within broad classes of employees, in favor of higher paid and supervisory employees. These are believed to be reasonable and fully adequate.

Furthermore, the recommendation is objectionable because Federal intrusion into an area of employer economic judgment—or, in the case of negotiated plans, to the process of collective bargaining—would hamper not only the growth and development of private pension plans, but would have an adverse impact on the entire matter of employer-employee relations.

Pension plans are only one part of the compensation structure and working conditions of an organization. There is no more reason for the Federal Government to intervene in labor-management pension plan benefit decisions than there is for the Government to dictate all questions of compensation between employers and employees.

A question was asked :

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?

The effect of this change alone would be minimal since many plans now provide for waiting periods of less than 5 years.

However, for some companies, especially smaller ones with high employee turnover, a requirement to shorten the waiting period would mean the difference between a meaningful program or a mediocre plan or none at all because of the additional costs involved.

For example, pension plans which are implemented by individual life insurance policies and many profit-sharing plans, both of which are among those used by small employers, would be seriously handicapped by such increased costs.

The recommendation is objectionable on the basis that restriction of a company's flexibility to adopt a program most suitable to its needs and financial capabilities would impede progress toward the objective of securing private pension plan coverage for additional numbers of employees in the area of greatest potential growth.

At this point I would just like to mention an item that was not covered in the President's report and that is the type of situation in which a corporation will have a pension plan and a profit-sharing plan covering the same group of employees. Each of these plans might in themselves not meet the coverage or vesting requirements that were set forth as recommended in the President's report.

But, taken together as an integrated program, they might well be quite liberal and more than meet these standards. This highlights

one of the problems in trying to legislate with respect to a particular segment of an employee benefit program.

It is also well to note that many of the pension plans in existence today that have low waiting periods of 1 or 2 years, or none at all, started out initially with a 5-year waiting period which was gradually reduced as each employer saw that he could bear the additional cost. It is entirely possible that limitations such as those suggested by the President's Committee would have impeded or deferred many plans that are now operating today within those limitations.

The last question to which we were asked to address ourselves is:

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

Again, we must object to the concept, implied in this question, that there is a Federal cost or subsidy to the employer in connection with private pension plans—any more than for other ordinary business expenses, payrolls, depreciation, et cetera. The accumulation of pension plan reserves:

(a) Provides a source of stability to the economy by providing purchasing power to a large and growing segment of the population;

(b) Greatly reduces the number of elderly who would otherwise become public charges to be supported through general taxation;

(c) Increases the amount of disposable income of the working population by reducing the requirement for substantial savings for ultimate retirement—thereby stimulating the current economy;

(d) Provides a source of job-creating debt and equity capital, through investment in corporate securities, real estate mortgages, et cetera.

Again, we must stress that the tax to the employee is merely deferred.

As for additional legislation suggested in the questions which we have answered, we believe it may do more harm than good—and as pointed out in our answers to your questions 15 and 16, may actually curtail further growth of private pension plans.

In conclusion, we believe that the objective of extending effective pension plan coverage to additional employees can best be served by:

1. A Government climate, free from hampering restrictions, which encourages the establishment of new plans, especially by smaller employers and the improvement of existing plans.

2. Voluntary private pension plan action programs of the national chamber and other organizations.

3. Freedom for the operation of traditional employer-employee relationships including the collective bargaining process.

4. Proper utilization of presently existing Federal and State laws, decisions, and regulations.

We believe that further governmental intervention will impede rather than promote the extension of effective private pension plan coverage to maximum numbers of employees.

This concludes our statement, Mr. Chairman. Mr. Shepherd and I will be glad to answer any questions regarding the statements which we have made in behalf of the Chamber.

Senator RANDOLPH. Thank you, Mr. Lindberg.

Mr. Shepherd and Mr. Lindberg, do you believe that these hearings are held at an appropriate time? Do you believe that we need to go very carefully into not only the President's report, not only into certain proposals which are pending or will be pending in the Congress,

but, also, we should study the history of private and public pension plans and profit-sharing plans, the role of the Federal Government, and the dangers you have indicated?

Do you feel that this is a constructive effort? The subcommittee wants to make it such and we would like to have your comment on that point.

Mr. SHEPHERD. Yes, Senator, I would like to comment on that. I think it is appropriate to have a full discussion of all aspects presented by private pension plans today. I think it is an area where its characteristics should be gone into carefully and not too fast. These things are rather complicated as has been brought out.

There are different points of view. We think it is well to look into these things but not to take too hasty action and not to jump to conclusions too fast. We who have had something to do with the private pension plan developments in this country are very proud of the achievements that have been made very largely over the last 20 some years.

We think that the private pension plan sector of the economy has grown in importance. I think the President's report recognizes that. It has been done under some handicaps, let us say, as we have pointed out in the answers to some of your questions. We believe that it can be given more freedom, it can be given great freedom to continue to expand.

I think you, yourself, Senator, in response to one of the other witnesses, recognized that the pension plans do something more than provide income in retirement years. They are an important factor in the whole employee-employer relationship. They lead to stable working forces, which is desirable. They add to the morale of the working forces.

And in dealing with profit-sharing plans in particular, I think we recognize that they do have a strong incentive for increased productivity and efficiency that we hope comes about through all of the things that employers and employees can do to really foster the main elements of our economy.

Perhaps Mr. Lindberg would want to add to that.

Senator RANDOLPH. Yes, Mr. Lindberg.

Mr. LINDBERG. I can add only to emphasize the point we made in our testimony which I think bears out the very statement you made. This is an excellent time to review this matter with the idea of providing a climate of certainty. If this is being nibbled at continuously bit by bit, one really never knows if one puts in a plan, what might be around the corner tomorrow.

Having a good, hard, long look, as you indicated, and coming up with the definite establishment that the status quo is the way we are going to have it, or that certain areas will have to change, will at least clear up the area as to where we are going from here.

Senator RANDOLPH. Mr. Shepherd and Mr. Lindberg, I assure you that that is the purpose of this subcommittee. I am pleased at the forthrightness with which you have answered these questions that the subcommittee has presented to you. There are areas of disagreement, there are areas of clarification which perhaps can come from these hearings, from the counsel of those in the very center of our business area and Government life.

Mr. Norman, I believe you have a question.

Mr. NORMAN. Thank you, Mr. Chairman.

Gentlemen, in your statement you have taken strong exception to the idea that a Federal statute giving favorable tax treatment to pension plans is a tax subsidy or a tax loophole or that it should be considered a revenue loss. But even if we were to consider it as such, say we would consider that there is a tax subsidy of \$3½ billion a year, if we were to accept that concept, do you think that it would be an accurate statement that this \$3½ billion a year of revenue loss or tax subsidy or tax loophole, whatever you want to call it, is a means of producing several times that amount of retirement income? For example, I believe the President's Committee report estimates that in 1980 the annual amount of retirement income provided by private pension plans will be \$9 billion.

Is it a valid conclusion that by giving up three and a half billion dollars of tax income annually today the Federal Government is sowing seeds which will produce a harvest of retirement incomes in 1980 to the tune of \$9 billion a year, or are there flaws in that concept?

Mr. LINDBERG. No, sir. We believe that is part of the underlying reason for our feeling that this does not represent a form of loss to the economic climate. The points that you made are those in which we firmly believe, that this money is seed for the future.

At the present time, we also believe that by the establishment and mere presence of private pension plans and profit-sharing plans and other forms of deferred employee benefit programs that employees or workers who might otherwise have to build substantial savings for their retirement years are able to commit more of their take-home pay for services and goods.

The fruits of this national private program are very very much in excess of any possible concession of revenue loss.

Senator RANDOLPH. Do I understand you correctly that these fruits would not inure solely to the benefit of the retired individuals but to everyone in our economy?

Mr. LINDBERG. That is correct, Senator. The under-age-65 population is not unmindful of its future security, thereby releasing funds into the economy they might have to save for this. The private pension plan sector is designed to supplement the social security program and is designed to provide a form of retirement income, but not exclusively all that a man should perhaps want for himself.

We are certainly in favor of individual thrift and enterprise to supplement these private programs. Nevertheless, a private pension plan can become an important part of each person's future financial arrangements and security of which we have found most people are not unmindful.

Senator RANDOLPH. Do I understand you correctly as businessmen you recognize that private pension plans promote the economic health of the country not only today but in the future as well?

Mr. LINDBERG. Yes, Mr. Chairman, I daresay that if by chance the private pension plan benefit structure were to be cut off as of any given moment it would make quite an impact on the economy.

Senator RANDOLPH. An immediate impact, not just one in the future?

Mr. LINDBERG. That is correct, sir.

Senator RANDOLPH. Thank you, gentlemen.

(Subsequently, the following copy of a letter regarding the testimony of Messrs. Shepherd and Lindberg was received for the record:)

WESTINGHOUSE ELECTRIC CORP.,
March 10, 1965.

HON. W. WILLARD WIERTZ,
Secretary of Labor,
Washington, D.C.

DEAR MR. SECRETARY: I would like to take this opportunity, on behalf of Westinghouse Electric Corp., to register our endorsement of the statement presented on March 5, 1965, before the Subcommittee on Employment and Retirement Incomes, of the Senate Special Committee on Aging, by Pearce Shepherd and Jean Lindberg representing the Chamber of Commerce of the United States (a copy of such statement is enclosed).

I would also like to point out, in addition to the important points raised by Mr. Shepherd and Mr. Lindberg in response to the specific questions to which they were asked to address themselves, that certain of the recommendations contained in the recent report entitled "Public Policy and Private Pension Programs," issued by the President's Committee on Corporate Pension Funds and Other Retirement and Welfare Programs, would, if implemented, create very serious problems for Westinghouse. While I am not going into detail in this letter concerning them, I would be pleased to review them with you should you care to do so.

Yours very truly,

R. I. BLASIER,
Vice President, Industrial Relations.

Senator RANDOLPH. We will continue our session on Wednesday, March 10, at 10 a.m., in this same room, with Sidney Zagri, the legislative counsel of the International Brotherhood of Teamsters, as a witness. Also appearing will be Charles Siegfried. He will represent the American Life Convention and the Life Insurance Association of America. Also at that time we will receive testimony from the National Association of Manufacturers, the name of whose witness or witnesses has not yet been communicated to the subcommittee.

I am very grateful for the attention today of our audience. We are appreciative of the splendid cooperation of the witnesses.

Good afternoon.

(Whereupon, at 12:50 p.m., the hearing recessed, to reconvene on Wednesday, March 10, at 10 a.m.)

EXTENDING PRIVATE PENSION COVERAGE

WEDNESDAY, MARCH 10, 1965

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

The subcommittee met at 10:12 a.m., pursuant to recess, in room 3110, New Senate Office Building, Washington, D.C., Senator Jennings Randolph (chairman of the subcommittee) presiding.

Present: Senator Randolph.

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

Senator RANDOLPH. Good morning, ladies and gentlemen.

We were to have listened this morning to testimony from the International Brotherhood of Teamsters, presentation being programed for the legislative counsel, Mr. Sidney Zagri. Mr. Zagri has contacted the staff and has indicated that he will find it impossible to appear today. Whether he will file a statement or appear in person we are not advised, but I do make this announcement for him as I understand that he is unable to be here today.

We are privileged to have Mr. Charles A. Siegfried with us this morning.

Mr. Siegfried, will you please come to the table and present your statement, as you desire. If you care to have the statement considered as read and then make comment on it, we would certainly want you to proceed in that manner. Or, if you prefer to read the statement as it has been given to the committee and then counsel with us in response to questions or stress certain points, you may do so.

We want to make you feel comfortable this morning.

**STATEMENT OF CHARLES A. SIEGFRIED, SENIOR VICE PRESIDENT
AND CHIEF ACTUARY, METROPOLITAN LIFE INSURANCE CO.,
REPRESENTING THE AMERICAN LIFE CONVENTION AND THE
LIFE INSURANCE ASSOCIATION OF AMERICA**

Mr. SIEGFRIED. Thank you, sir. If it is agreeable, I would prefer to read it and proceed from there.

My name is Charles A. Siegfried. I am senior vice president and chief actuary of Metropolitan Life Insurance Co., and I am appearing today on behalf of the American Life Convention and the Life Insurance Association of America. The membership of these two organizations totals 330 life insurance companies. These com-

panies have outstanding practically all of the insured pension business in force in the United States.

We are pleased to have the privilege to appear at these hearings to discuss with you certain aspects of Federal policies to encourage the extension of private pension plans. Our member companies have been widely and actively engaged in setting up and extending pension plans for many years, so that a large number of insurance company administered plans are currently in operation. This is an important area of life insurance company operations.

We distinguish three areas of responsibility for providing income to persons who have reached retirement age. The basic responsibility rests with the individual. Many millions of our citizens accept this responsibility by utilizing individual life insurance, endowment, and annuity contracts offered by life insurance companies, as well as through individual savings plans of various kinds. The Federal social security program reflects a second area of responsibility, that of society as a whole.

The life insurance business has long supported the principles of a sound social security program, aimed at providing a basic layer of income protection for retired workers. Benefits provided by employers, or by employers and employees jointly, constitute a third source of retirement income. Many of the questions that exist in the field of pensions and retirement income relate to the matter of achieving a desirable relationship and balance among these three areas of responsibility.

Insurance companies first undertook to insure pension plans about 1930. Since that time there has been a great expansion in the number and types of insured plans administered, in the number of persons covered, and in the reserves accumulated for benefit payments.

At the end of 1963, there were 47,460 insured plans in effect covering 6.1 million persons. Reserves aggregated \$23.3 billion. Annuity payments are now being paid at the rate of \$570 million a year. The dynamic character of these insured plans is indicated by the fact that reserves have increased about 50 percent in the last 5 years, and there has been a 23-percent increase in the number of persons covered in this period.

We might subdivide the pension plans administered by insurance companies into three broad types. The first type, which may be called the group annuity plan, is characterized by a single master contract with certificates issued to persons for whom annuities have been purchased. Four out of every five persons covered under insurance company administered plans come under a plan of this type.

In some of these plans units of annuities are purchased at regular intervals during active employment in accordance with a prescribed schedule. In others the prescribed annuities are provided when the employees reach retirement age, from funds accumulated during their working years.

The second broad type of plan is the individual policy pension trust plan. This plan uses separate individual policies, usually on a whole life or endowment insurance basis, for each employee. While such individual policy pension trust plans account for nearly three out of every four insured plans, they cover only about one out of five of those employees covered by insured pension plans, since these individual policy plans are used primarily by smaller firms.

Finally, there is the third type of plan, the "H.R. 10" plan under the Self-Employed Individuals Retirement Act of 1962. These plans may use either individual life insurance and annuity contracts, or group contracts.

The three categories of plans are mentioned to draw attention to the fact that insurers have sought to develop plans that serve the special requirements of employers of varying sizes, as well as plans for use under the Self-Employed Individuals Retirement Act of 1962.

Before going further I should tell you that our two associations have not formulated policy on all of the various issues that are currently being discussed in this area. The recent report of the President's Committee on Corporate Pension Funds and Other Retirement and Welfare Programs contains a long series of recommendations. Your letter refers to some of these points and adds others.

In sum, there are a great many questions involved, and some of them are very complicated. We are currently studying these questions very seriously. It may be some time, however, before our two organizations have determined upon policy on all of these questions. I hope you will understand therefore if I am unable today to be specific in all respects.

I will turn now to the particular questions which you suggested for our attention in your letter of invitation.

Senator RANDOLPH. Thank you for responding to those questions. We felt this would make the record more helpful to the subcommittee members and the subcommittee would like for the full committee to have the benefit of the responses to those questions in your testimony.

Mr. SIEGFRIED. I will deal with those.

Senator RANDOLPH. Thank you.

Mr. SIEGFRIED (reading) :

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?

We think the answer to this question is clearly "yes." Ours is a large and diverse society. Private plans make possible a high degree of flexibility to meet different retirement needs and wishes, as contrasted with Government programs which necessarily have a high degree of uniformity and should be restricted to meeting only basic needs. Private plans can reflect varying desires of individuals to forego current consumption for future income and security. Private plans can also accommodate a wide variety of views in collective bargaining situations, in choices between cash wages and various supplementary benefits, including pensions, and such other benefits as medical care. The area of choice is very wide, and a great measure of freedom seems highly appropriate and desirable. Clearly it would be desirable for the Government not to inhibit or discourage private, voluntary effort of this sort.

The form and the extent to which Government should make positive moves beyond those which have already been made deserves continuing, careful thought. The measures that have been utilized thus far, particularly as reflected by tax laws, are in general meritorious. We favor reasonable flexibility and an avoidance of burdensome complexity in rulemaking and administration.

What advantage do private pensions offer from the standpoint of the employee? the employer? the Federal Government?

The interest of an employer in pensions for his employees stems from the fact that a pension plan affects importantly the welfare of a business or corporate enterprise. It is advantageous to an employer in attracting the right kind of employee, in stimulating each employee's contribution to the enterprise, in encouraging his continuation in service during his productive years, in providing opportunities for advancement for younger people by making provision for the replacement of older employees at retirement age, and in general in fostering a vital work force conducive to the efficiency and success of the enterprise.

Private pension plans also offer an employer a practical means of financing the cost of providing retirement benefits during the working years of an employee's lifetime. This accords with sound accounting principles. Current funding of private pension plans during active working years affords an employer much greater control over and appreciation of his true employment costs than does deferral of the payment of retirement costs until after the employees actually retire.

From the point of view of the employee, the advantage of private pension plans is that they constitute one important method of providing for his retirement. These plans supplement what the employee can expect in benefits under old-age survivors insurance, which is properly designed to provide no more than a basic floor of financial protection, and what the employee can expect in financial security from his own personal savings.

Since the Federal Government allows substantial tax relief on qualified private pension plans, the use of such plans increases the amount of retirement benefits that can be provided for a given outlay. Moreover, since money put aside in private pension plans is generally not available to employees until paid out as retirement income, it is not subject to the spending temptations before retirement so typical of other forms of savings.

An important advantage of private pensions to the Federal Government is that they diminish the need for costly Government programs for older people. A further advantage lies in the accumulation of large sums of investment capital, which contribute greatly to the economic growth of the country, and in turn produce increased income and increased Federal tax revenues. Furthermore, pensions stimulate the efficiency and success of business enterprises so that they add to the economic well-being of the country as a whole.

These, we feel, are some of the reasons why the Federal Government should encourage the development of private pension plans.

The next question is:

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?

The current tax incentives for private pensions cannot in any sense be considered a "tax loophole." Instead they constitute a tax inducement to employers and employees to provide a private enterprise answer to retirement needs, with important advantages to the Federal Government.

The report of the President's Committee on Corporate Pension Funds estimates that the revenue loss to the Government as a result of this special tax treatment is more than \$1 billion annually. We

have not sought to make an estimate on this score. We would point out, however, that in the absence of private pension plans there would be a much greater need for Government assistance to the retired. Private pension plans save the Government untold dollars in the form of the social burden which is thus shouldered by private enterprise.

Moreover, the President's Committee concluded that, regardless of any such revenue loss, private pension plans are definitely in the public interest and should continue as a major element in the Nation's total retirement program. We agree with this conclusion.

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

Except for several items to be mentioned later, the associations I represent do not at this time have any specific suggestions as regards new Federal statutes or the amendment of existing statutes. However, we do have some general observations as to the role of the Federal Government in maintaining a climate in which the private pension system can flourish and expand.

First, we earnestly recommend that a prime objective of Federal monetary and fiscal policy be to contain inflationary pressures wherever and whenever they appear so as to maintain the stability and purchasing power of the dollar. Unrelenting determination on the part of the Federal Government to maintain economic stability will constitute a strong underpinning for pension security.

Second, we urge that tax discriminations against insured pension plans be eliminated, and that no new discriminations be created by future legislation or regulation. Insured pension plans do not presently qualify for quite the full income tax relief which is accorded un-insured pension trust plans.

Third, in the interests of keeping the administrative costs involved in the operation of private pension plans within a reasonable level, legislation and regulation should be aimed at reducing, as far as possible, onerous burdens of recordkeeping and tax reporting information not clearly essential to the sound operation of the pension plan itself.

Fourth, in evaluating the recent report of the President's Committee on Corporate Pension Funds and its recommendations, a paramount objective should be to foster a climate in which new pension plans can be established and existing plans can be extended or be made more adequate. The need for flexibility in the design of private pension plans should be clearly recognized, especially in considering proposals which seek to protect pension plan participants but which may operate against their best interests as a whole by imposing unnecessary restraints.

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?

To a large extent, the retirement problems of farmers are similar to those of other self-employed persons. Some of the problems here arise from the inadequate provisions of the Self-Employed Individuals Retirement Act of 1962, H.R. 10.

As for employees of farmers, their problems are generally the same as those of employees of other small unincorporated employers,

plus the problems inherent in making systematic provision for the retirement of employees who are often temporary or seasonal. Perhaps multiemployer pension programs for the employees of farmers associated together for some specific purpose may be a solution, similar to the multiemployer union bargained pension plans that have been worked out for certain industries and areas. At best, however, such a development would require a lot of time and study. Hence, the immediate answer would seem to be a liberalization of H.R. 10, which is discussed in more detail below.

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?

Actual figures on utilization of the new act are not readily available. In our experience, however, self-employed individuals have been slow to adopt these plans. The reasons seem to be the stringent rules for inclusion of new employees, the vesting requirements, and the limited tax deduction permitted. The self-employed person is required to include all full-time employees regardless of age who have as much as 3 years' service with him, and all contributions on their behalf must be fully vested from the start.

Yet the self-employed's deduction for his own coverage is limited to one-half of his contribution, which in turn is limited as a general rule to 10 percent of his earned income or \$2,500, whichever is less. Thus the tax benefit to the self-employed is quite small in the usual case, and available only at the price of establishing a pension program for employees more costly and more liberal than is required under pension plans established by incorporated organizations.

Self-employed who have adopted H.R. 10 plans generally make modest contributions on their behalf. Under the present act, the self-employed person cannot withdraw any amounts, in the absence of disability, until he reaches age 59½. This requirement, whatever its justification, acts as a deterrent. Admittedly there are reasons for this enforced retention of savings, but it must be recognized that for many this feature is a strong deterrent to the utilization of the act.

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

Obviously, the Self-Employed Individuals Retirement Act of 1962 would be made more effective if the present limitation on deductions to one-half the contribution of the self-employed person for his own coverage were removed. It would also be made more effective through elimination of the costly requirement of providing vested coverage for very young employees, many of whom do not intend to remain in employment and whose eventual benefits will be almost meaningless for retirement purposes. There are other restrictive provisions which require thorough reconsideration.

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?

In the past few years more than half of the States have enacted legislation permitting some or all professions to conduct their practice in association or corporate form—a substantial departure from the laws of just a few years ago. A number of existing professional firms were planning to operate under these laws and to establish

qualified pension plans. Just recently, however, the Treasury Department issued final regulations making clear its intention not to recognize such corporations or associations as such for pension plan tax purposes. In fact, the Treasury regulations would seem to raise questions as to the validity, for pension plan tax purposes, of many personal service corporations of long standing. The result is to provide a serious obstacle to the establishment of pension programs for professional people and their employees.

Failure of the Internal Revenue Service to recognize professional service corporations and associations as true corporations means that the pension plan tax incentives of the code are rendered inapplicable to one type of corporation recognized by State law while remaining applicable to other types. A considerable number of professional people is involved. We believe this discrimination should be removed.

Again, I thank you for this opportunity to appear before your subcommittee on this important subject.

Senator RANDOLPH. Thank you very much, Mr. Siegfried.

In your statement, on page 128, there is a paragraph in which you indicate that the Federal Government, to use your exact words, "should encourage the development of private pension plans"? Just how can this be done?

Mr. SIEGFRIED. This has been done up to this point by the operation of the tax laws by enabling employers to make deductions for pension plans a deductible business expense, by exempting the income from pension funds as income currently taxable through the tax mechanism. Generally, this kind of encouragement has been provided. We think this has been meritorious and appropriate.

Senator RANDOLPH. I realize that there are many, many ways in which this can be done. Of course you have suggested some here today. I wanted to hear from you as to whether you believe that we should step up our effort in a program of stimulating and encouraging extension of private pension coverage that would not be limited to measures dealing with the tax structure, but would also include an effort by the Federal Government to apprise the people of the value of pension plans.

Do you believe there is any value in such a promotional campaign, or would you stay away from that approach?

Mr. SIEGFRIED. I have indicated a few areas in which I thought the Federal Government might be helpful by the creation of a favorable climate, maintaining the sound value of the dollar. A continuance of policies of that kind would seem to be adequate and to be very necessary and helpful. Whether any further actions are necessary or desirable, I don't know. That would require some further thought. I am inclined to think not.

Senator RANDOLPH. Thank you, Mr. Siegfried.

As you know, it appears these days that if the Government believes that some program is desirable, the program is given a stimulus from the White House; not only from the Congress. The thinking of the administration is carried to the people in some affirmative action.

Do you think this is the time when the Federal Government should attempt to focus public attention on the value of private pension coverage?

Mr. SIEGFRIED. As I tried to indicate, life insurance has been very much interested in this field for many years. We have been trying to spread the message and trying to sell the idea of pensions and spread the establishment of pension plans.

For a period of years we operated under considerable handicaps through the tax laws and certain other developments that inhibited us. This has been cleared up through amendments made to the tax laws in the recent past. We think that there now exists a generally favorable climate in which this business can be carried on. So we are doing our part, doing a great deal, in the way of spreading thoughts as to the desirability of pensions.

I would question whether any other effort is greatly needed.

Senator RANDOLPH. Thank you, Mr. Siegfried.

Will you turn to the middle of page 129? You recommend, I quote:

Tax discriminations against insured pensions plans be eliminated.

Will you be more specific and help the subcommittee know what, exactly, you are thinking?

Mr. SIEGFRIED. It is a technical point, but the fact is that insured pension plans are currently subject to an amount of taxation that is not true of uninsured plans. This comes about because in computing the investment income that is excludable on pension plans, we are required to make a computation on the basis of the company as a whole, lumping the pension business with the insurance business.

The net result of this is to bring under taxation a certain small part of the investment income from the pension operations and thereby subject it to tax which wouldn't come about if it was under a non-insured pension trust.

Then also, insured plans are subject to a tax on capital gains which is not the case under noninsured trustee plans. It is a small area, but it is still an area that we think deserved to be cleared up.

Senator RANDOLPH. Mr. Siegfried, as I read your statement, I noted that immediately after this recommendation which you have now discussed, you recommend the reduction of the "onerous burdens of recordkeeping and tax reporting."

We hear that constantly and I think it is a valid objection in large part. Would you submit for the record of the subcommittee, before it closes its hearings or before we bring any matters before the full committee, a list of changes that the life insurance industry would recommend as eliminating unnecessary paperwork without, in your judgment, substantially handicapping the Government's surveillance of pension plans? Would you want to do that?

Mr. SIEGFRIED. I wouldn't feel adequate to respond at this moment, but this is the impression of many people, made up of many things.

The end result is that they are surrounded by a considerable volume of rulemaking and paperwork that should be simplified.

Senator RANDOLPH. You are not only surrounded, you are submerged. You will do that?

Mr. SIEGFRIED. Yes, sir; I will.

Senator RANDOLPH. Thank you, Mr. Siegfried.

(The following letter was later received from Mr. Siegfried for the record:)

METROPOLITAN LIFE INSURANCE CO.,
March 12, 1965.

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

DEAR SENATOR RANDOLPH: In the course of my appearance before your subcommittee on March 10 on behalf of the American Life Convention and the Life Insurance Association of America, you referred to my statement on page 8 recommending that efforts be made to reduce burdensome recordkeeping and reports.

These thoughts were suggested by certain problems that have grown out of the Welfare and Pension Plans Disclosure Act. There are indications that the act may be construed as requiring the inclusion of the master group contract as part of the plan description. The plan description, in turn, is material that can be obtained on request by each plan participant. Since the master contract is frequently a large document, and in some cases runs to hundreds of pages, we believe that a requirement that this material be furnished to all who request it could be an onerous procedure.

There are several other problems arising from this same act that could involve cumbersome records and reports in situations where two or more employers are involved in a pooled insurance arrangement, or where a single employer has two or more plans that are pooled.

While no final decision has been reached on the matters referred to, and while we are hopeful that a satisfactory solution will ultimately be found, we believe these situations are illustrative of the kind of complexity it would be desirable to avoid or minimize. We believe the caution we express is in order because the burdensome results we observe are frequently not the result of specific intent, but rather an unexpected, unintentional result flowing from some objective.

I appreciate the opportunity to furnish these further observations.

Sincerely yours,

C. A. SIEGFRIED,
Senior Vice President and Chief Actuary.

Senator RANDOLPH. Mr. Norman?

Mr. NORMAN. Mr. Siegfried, when your company establishes a pension plan for a business, is it entirely apart from the pension plan of another business? Is there any portability where an employee of a Metropolitan plan in one location may go to work for an employer who has a Metropolitan plan in another location and still maintain his same coverage, or would he have to enter an entirely new pension plan if he made that change?

Mr. SIEGFRIED. First, I would like to emphasize that we have all kinds of plans, because the pension field is a very large field. There are many different kinds of plans with many different kinds of provisions. We do have available under insured plans a mechanism whereby an individual, if he moves from one employer to another and becomes covered under a second plan or a third plan, he may, depending on the terms of the plan, retain certain rights and benefits under each plan under which he has been covered.

Mr. NORMAN. Is that a matter of just retaining his old coverage or the benefits of his old coverage without carrying over his rights into the new coverage, or is it a true portability?

Mr. SIEGFRIED. I would call it true portability in that assuming he has a vested interest in certain benefits under each of three plans through which he has moved and let's say they are all with the same insurance carrier, although that is not even essential, he would upon retirement get benefits from the three plans but from the one carrier.

Mr. NORMAN. That is assuming that all three plans are under the same carrier; is that correct?

Mr. SIEGFRIED. No. This is a feature of an insured plan. It would be true whether there was one insurance carrier involved, or whether there were several carriers. He could retain an identifiable right under each plan as he moved between different employers.

Mr. NORMAN. Exactly how does that work? Say the first plan is under carrier X, the second is under carrier Y, and the third is under carrier Z. Does that mean he would get three pension checks, or would he get one pension check, and if so, how do they work out between them who pays the check?

Mr. SIEGFRIED. Under the type of plan I have in mind, that is the first type I referred to in my statement, he has an identifiable amount of annuity that he has a right to from his employment with employer A. When he leaves, if the plan provides that he has a vested interest in that, that remains with that company. So he has a certain number of dollars of deferred annuity payable at retirement. He goes to a similar plan with a similar provision with company B and he accrues certain rights. And then he moves on to company C. When he comes to retirement, let's say, he has had three periods of employment. He has rights owing to him under three separate contracts, but they are identifiable and clearcut.

It's true the arrangement I have in mind he would get three checks at retirement, but this we don't regard as a very difficult administrative problem. But there is portability in the sense in which I think it is used. It is a simple clearcut arrangement.

In other words, insurance people feel that there is within the insurance framework all the mechanism that is necessary for portability. I think that is the point you are interested in.

Mr. NORMAN. If he had not, say, worked for company A to begin with, but had only worked with companies B and C, would there be any difference in what he would receive from those plans than if he had worked for company A? Or is it just three separate pension plans that he had worked for and has earned certain credits in each one of the plans?

Mr. SIEGFRIED. The arrangement I am thinking of is one in which there is complete independence and separability of employers A, B, and C. So his employment with A, B, and C in the case I am thinking of would not be affected by lack of employment with employer A.

Mr. NORMAN. One thing that concerns us is this: Under the Internal Revenue Code an employer with a qualified plan can defer coverage for up to 5 years, at present. Suppose that all three companies have such a provision, 5-year deferment, and suppose this man has worked for each company 4 years, a total of 12 years. He would not get any pension, would he?

Mr. SIEGFRIED. Under that set of assumptions, no.

On the other hand, if these employers wanted to band together and set up a joint plan, then you would have a different set of facts and then by the terms of the plan, service with any one of the three could have been credited, and he would accumulate rights.

So you must first establish the factual situation as to employment. If there is no relation between employers, the first situation you described would hold. But if the employers chose to band together and

form an association, then the second situation you referred to could hold.

Mr. NORMAN. Could your company work out one big plan to which all your pension clients would contribute and from which all clients would draw benefits upon retirement? Would that be feasible?

Mr. SIEGFRIED. That is an arrangement which we have not encountered. But as far as the mechanism, we could handle a large number of employers joining together in a pooled type of plan. This is a possibility within the insurance framework.

Mr. NORMAN. There would be nothing in the Federal statutes that would prevent your doing so?

Mr. SIEGFRIED. Nothing that I know of.

Mr. NORMAN. If an employee of a company in, say, Bangor, Maine, that has a pension plan worked out by your company moves to work with an employer in Los Angeles, Calif., who also is on your company's plan, he could work 4 years then go on to Los Angeles, work another year, and qualify under the 5-year deferment, and then he would be under coverage; whereas if they were under separate plans, each a 5-year plan, he would have to work at least 9 years under those circumstances, 4 years with the first employer and 5 years with the second, to get any kind of coverage at all, wouldn't he?

Mr. SIEGFRIED. First, I think we would have to establish is there or is there not some relation between the two employers?

Mr. NORMAN. The only relation would be that they were both covered by your master pension plan.

Mr. SIEGFRIED. There would have to be some other relationship. The first company would not want to have its pension plan cost affected by some other company. They would want to stand alone. It would be if there was some other reason that brought the employers together so they chose to have a combined arrangement that the kind of system you are suggesting would work.

Mr. NORMAN. In other words, you are saying the principal reason why your company would not set up such a master plan would be that there would not be enough relation between the two companies to make them want to be under the same plan.

Say that the first one is a retail florist and the second a retail dry-goods store. Do you think under those circumstances perhaps they wouldn't want to be under the same plan?

Mr. SIEGFRIED. I have difficulty imagining why those two employers would want to join together. But if they do join together, we have insurance mechanisms available that would accommodate them.

Mr. NORMAN. Say both of them are in the retail dry goods business.

Mr. SIEGFRIED. They might have some common interest that would make it desirable that they would want to join together. We are very flexible and have a variety of mechanisms available to accommodate the needs and objectives of employers in different situations.

Mr. NORMAN. Do you know of any insurance company that has established such a master plan?

Mr. SIEGFRIED. I think there are a number. I don't have any personal knowledge that I can think of offhand, but my impression is that there are a considerable number of multiemployer plans that are insured. So the arrangement, I believe, you have described is actually in operation.

Mr. NORMAN. It would usually be an association of employers, or employees in one union, or something of that type?

Mr. SIEGFRIED. There would have to be some relationship and agreement and understanding between the employers that join together.

Mr. NORMAN. When you have a situation like that, is the employer able to join the plan merely by signing up and paying his contributions, or does he have to go through qualifying his plan, getting a determination letter, and hiring a lawyer and an actuary and all those other high initial costs?

Mr. SIEGFRIED. I would guess that there would be uniformity of the plan as between the different employers and that someone would act as the administrator and the organizing force and that this would simplify the problems for the particular employers. There would be advantages of that sort.

It is possible to eliminate much duplication of effort that would otherwise be involved if each employer undertook to qualify the plan himself.

I would like to emphasize that under insured plans generally they are so constructed that the work associated with qualifying and establishing it is handled for the most part by the insurance company and the employer doesn't have any great burden.

So the need for the kind of association you are referring to is not as great as might be suggested by the question.

Mr. NORMAN. I see. For all practical purposes, it is just a matter of signing up and paying contributions. He doesn't have to hire an attorney, or actuaries, or go through very much paperwork before he has a plan in effect in his business. Is that so?

Mr. SIEGFRIED. You are talking about a particular small employer?

Mr. NORMAN. Yes, sir.

Mr. SIEGFRIED. I would say we have plans that can be installed with very little effort.

Mr. NORMAN. He would have to get a determination letter but since the Internal Revenue Service would recognize it as a uniform plan of the type that they have accepted before, there probably wouldn't be much to that.

Mr. SIEGFRIED. It is my feeling that problems of that kind have not an important consideration in the expansion of pension plans.

Mr. NORMAN. Mr. Siegfried, do you believe that private pensions help to stabilize the economy, that they help to soak up excess purchasing power when inflation is threatening, and to buoy up the economy in times of deflation and bad economic conditions?

Mr. SIEGFRIED. You are covering a wide area and a variety of possibilities. I don't know that we have had experience that would give us a basis for competence in answering it. Certainly the existence of pension plans has been a stabilizing influence in providing retirement incomes for people who, in the absence of such income after retirement, might cause a dip in the economy through the removal of these people from the work force.

So I think it is clear that they are a stabilizing influence, but to what degree they would have influence during unusual times I would be hard pressed to explain. I do think, though, that generally speaking, they are clearly a stabilizing force in the economy and also a stimulating force.

Mr. NORMAN. Thank you very much, sir. You have been very helpful.

Senator RANDOLPH. Thank you, Mr. Siegfried. Your two associations through your presentation have cooperated with the subcommittee. You have been very frank to answer questions and where your policies have not yet been determined you have indicated that to us.

We want you to keep in contact with the subcommittee through the chairman, the staff, or the subcommittee members. We are trying to be cooperative, and we are not attempting to find the answers quickly. We know that this is a difficult area and we are attempting to move rather cautiously. But it is our purpose to ascertain the facts.

Thank you, Mr. Siegfried.

Mr. SIEGFRIED. Thank you. I am glad to have the privilege of being here this morning.

Senator RANDOLPH. We have the privilege now of hearing Mr. E. S. Willis, who appears for the National Association of Manufacturers, and who is with a very large manufacturing company. Mr. Willis, we are pleased to have you appear before us.

**STATEMENT OF E. S. WILLIS, MANAGER, EMPLOYEE BENEFITS,
GENERAL ELECTRIC CO.; REPRESENTING THE NATIONAL ASSO-
CIATION OF MANUFACTURERS**

Mr. WILLIS. Thank you, sir.

In the interest of conciseness and accuracy, I would like to read this, if I may, and then I will be pleased to answer any questions that you may raise.

Senator RANDOLPH. That will be helpful to the subcommittee.

Mr. WILLIS. My name is E. S. Willis. I am pleased to appear before this subcommittee representing the National Association of Manufacturers. I am manager of employee benefits and practices service for the General Electric Co.

The past decade has brought several social upheavals not the least of them an unprecedented search for economic security, particularly in old age. With three wars and a major depression falling within a single lifespan this quest for protection against real and imaginary fears is not hard to understand.

Unfortunately, deep concern seems to invariably generate pressures for premature or unsound action. Thus political and managerial leaders have periodically been asked to divert resources for the benefit of a particular group, regardless of the implications for other groups. We all recall the Townsend plan and the great appeal it held for those over 65.

We can be thankful that more often than not legislators have remained steadfast and have not been stampeded into unsound solutions. As a result we have side by side today a basically sound foundation of old-age security in the OASI system, together with a flourishing supplemental system of private pensions.

Whereas Federal involvement in old-age security was prompted by a cataclysmic event—the great depression—private pensions have had a long and evolutionary development. Private pension plans—not Johnny-come-latelies—have been in being for over 90 years. General Electric's plan, for example, has been in effect since 1912.

Private pensions reflect the sober judgment of employer and employees that security in the retirement years is well worth setting aside a portion of spendable income today. This recognition of the value of private pension plans has led to their remarkable growth. From a coverage of a little more than 5 million workers in 1940, they have expanded to a coverage of approximately 25 million today. More than 2 million beneficiaries are today receiving checks amounting to \$2.75 billion annually. Total reserves have reached \$75 billion and yearly contributions are running at the rate of \$6.5 billion.

This remarkable record testifies to the significant contribution that private pension plans are making to individual economic security in retirement. It demonstrates the beneficial contribution made to the entire economy in terms of purchasing power and available investment capital.

Clearly, private pension plans with their built-in flexibility to adapt to the almost infinite requirements of employees and employers should be encouraged to grow and prosper in a climate of certainty and approval. Needless regulation can prevent private pension plans from doing their best job.

There is, of course, a proper role for Government. The basic social security retirement system has received wide endorsement. Federal and State Governments already have laws to detect and prevent wrongdoing with respect to private plans. Guides for private pension programs are found in the Internal Revenue Code and under the Federal Disclosure Act. No Federal action ought be permitted to stifle the employer's interest in or the individual's incentive or ability to provide for his own future by private pension plans, by voluntary savings, and other investment opportunities.

Turning, for the moment, from general attitudes to the specific questions on which you have asked us to comment, we offer the following opinions as representative of present NAM thinking:

On the question of "Federal encouragement of private pension plans * * *"

We believe it proper and desirable for the Government to foster the further development of private pension coverage by creating an environment which will sustain present confidence in private plans. Nothing, however, will blight the promising future of private plans so quickly as detailed Federal standards or regulations as to benefit amounts, vesting and funding. Federal regulation should be limited to the domain of disclosure—the idea of making basic information on plans available to participants—and to the present scope of Internal Revenue Service regulations outlining basic ground rules for qualified plans.

Many problems have arisen because of the employee's failure to understand the exact nature of his rights under a pension plan. This problem can be solved by perhaps more meaningful disclosure and education among employers, employees and, where they are involved, labor unions.

Questions relating to benefits and eligibility are best left to resolution by employer and employees in their normal processes. National standards in these areas are inappropriate where such diverse elements come to bear as company finances, age of the work force, type of product, number of employees, geographical location and desires of

the employees. Federal standards which would add additional costs or limit flexibility would also discourage the adoption of new plans, especially among the smaller companies.

On the question of the "advantages of private pensions to the employee, the employer, and the Federal Government * * *."

Private pensions have helped provide even more meaningful income for the retirement years. For the first time in history employees and employers have been able to put substantial sums to work at their own discretion. Though the results can be calculated in dollars and cents the social dividends in the form of greater dignity and improved standard of retirement living for all employees are inestimable. We have witnessed a new era of independence where employees have great latitude in shaping the last decades of their lives.

From the employer's vantage point private pensions constitute a key element in employee relations and employee compensation. These plans ease the anxieties of individual workers as to their future security. In periods of intense competition for skilled workers a sound pension plan is essential to attract a competent work force.

The Federal Government benefits from private pensions in direct proportion to the increased affluency of our aged population. By saving for their own futures, citizens of today are reducing the burden of future generations of workers who might otherwise be required to finance welfare programs for the then retired. The accumulation of capital in pension trusts also assures a considerable fuel supply for a growing economy, so essential to a strong nation. Funds for modernization made available through private savings will help to enhance our strength as a competitor among other nations thus easing the pressures on our gold supply generated by an unfavorable balance of trade.

On the question of "revenue loss being more in the nature of a tax loophole * * *."

Reasonable employer contributions to pension plans have long been recognized as a legitimate cost of doing business. Indeed, they should be treated as a deductible item the same as wages and salaries and other business expenses since they are in a true sense payments in lieu of wages or part of normal working conditions—both deductible items.

The employer deducts his contributions to a pension fund, and the pensioner pays taxes when he receives income resulting from the contributions. This is consistent with the contractual and economic nature of the transaction—any other treatment would tend to frustrate the development of private pension systems. It is also consistent with the longstanding congressional intent that the very essence of our Federal income tax has been that it is a tax on net income. There is no greater justification for tagging pension plan contributions as tax loopholes than there is in calling wages and salaries tax loopholes.

The elimination of the deduction would only penalize employees and the economy to a far greater extent than the alleged tax loss from loopholes. Not only would the present employer contribution produce smaller pension benefits or greatly increase company costs, but any increased employee contribution required to maintain a given pension level would reduce considerably the amount of direct and immediate consumer purchasing power and would undoubtedly lead to urgent

demands for tax relief on employee contributions such as now exists in Canada. This is the wrong way for the Government to save money.

Clearly, the present treatment of pension plan contributions and of income from pension plan funds represents a sound investment in future retirement income and in the economic stability and prosperity of Americans of all ages. Few arguments could rest on shakier foundations or be more misleading than to support greater Federal regulation of private pension plans on the theory that pension plan contributions are tax loopholes.

On the question of "what Federal action would contribute to the extension of private pension plan coverage * * *."

We believe that present attitudes, if allowed to stand, will assure the rapid extension of private plans to all employees who desire coverage. The greatest inhibiting factor to further growth is an uncertain climate in which there is the continued likelihood of more Federal control of private plans through arbitrary standards.

The trend in pension coverage is up, growing apace with the increase in jobs. Much if not all of the future new pension growth will be in the green pastures of smaller firms in which there is a great need for initial flexibility with regard to eligibility, benefits, and financing in order to get a pension plan started. Business' ability to take on new cost obligations will be dictated by the market itself; this is the inflexible law of business.

An understanding Federal attitude will be expressed by rejecting standards and other unnecessary controls and by encouraging maximum flexibility to meet the needs, desires, and financial abilities of both employees and employers.

On the question of the possible effects "arising from elimination of the option to cover only salaried or clerical employees * * *."

The chief objection to this recommendation requiring the coverage of both hourly and salaried employees under pension plans is not because of disagreement with the concept, but rather that the result would be reached by Government compulsion. Employees and employers should be permitted to decide by themselves what type of coverage best meets their particular situation. It may well be that one group would rather have larger wages, longer vacations or some other compensation arrangement than a pension plan. The parties should be free to make this decision. Normal competition for employees will continue to generate effective pressure for extension of coverage as fast as is feasible.

On the question of reducing the "maximum waiting period for coverage from 5 to 3 years * * *."

While to the usual corporate plan this change would be minor since most of these plans have shorter waiting periods—the objection to the recommendation is the same as that outlined in the previous question. The fact that many existing plans have this provision does not justify its required inclusion if the more basic principle of maximum flexibility would be violated. Regulation should avoid handicapping the institution of new plans. More liberal waiting periods might retard the adoption of new pension plans.

NAM is concerned that legitimate Federal interest in private pensions may stray beyond the bounds of minimal regulations as expressed in present IRS regulations and present Federal Disclosure Act requirements to the point that private plans may become solely creatures of Government.

As recently as 1958 the Federal role, aside from IRS tax rules, was restricted to the principle of full disclosure of plan details to beneficiaries, as set forth in the Welfare and Pension Plans Disclosure Act. In 1962 the Disclosure Act was broadened to require bonding of administrators; "teeth" were added to give the Secretary of Labor broad investigating powers; finally, new penal sanctions for fraud, dishonesty, kickbacks, and so forth, were adopted.

More recently, the appointment of a Cabinet-level committee to study pension practices seems to be an indication that perhaps more stringent controls are being contemplated. This belief is confirmed by the recent report of this committee recommending several key standards which introduce a new element of uncertainty.

There may be a place for serious studies and recommendations for constructively strengthening the private pension program. But let us not magnify any minor weaknesses so as to cripple the strong institution which helps guarantee that individual retirement security is not founded on just one relatively inflexible Government program.

Continued management and employee faith in the utility and soundness of voluntary pension plans is essential.

Employers want the best possible solutions to these complex retirement security problems, but they want things done the American way; the voluntary, private enterprise way. European nations, in the tradition of Bismarck and Beveridge, have chosen another route: virtual centralization of retirement security.

We reaffirm our belief in the private pension plan as the desirable and necessary supplement to all public programs. Our goal is to improve and encourage the growth of private plans. We applaud the efforts of this subcommittee toward this objective.

Thank you, sir.

Senator RANDOLPH. Thank you very much, Mr. Willis.

I note on page 141, above, you say:

There may be a place for serious studies and recommendations for constructively strengthening the private pension plan program.

Our subcommittee would like to feel that there is a place, not that there may be a place. But you may be assured that the chairman of the subcommittee would resist any and all efforts which might be made to cripple private pension programs.

Yet, I do feel that there is a valid reason at this particular time to find the areas in which the private pension plan coverage can be made a stronger supplement to the public plans for providing retirement incomes.

We, on the subcommittee, are grateful that you have seen fit to close your statement by saying that you believe that what we are doing here is objective, is constructive, and will be helpful. I assure you that is what we want to do. I would not permit, in my own capacity, any violence to be done. I think we do now have a challenge to be more knowledgeable in this field and to help the very purpose which you have delineated to the subcommittee this morning.

Mr. WILLIS. There is always an opportunity for study of anything to make sure that it is doing its best, and I am glad to hear your statements on this, Senator; it is very reassuring.

Senator RANDOLPH. Thank you, Mr. Willis.

Mr. Norman.

Mr. NORMAN. Mr. Willis, you have indicated that you believe that a Federal effort to interfere with the flexibility of private pension plans might be a serious impediment to the further extension of private pension plan coverage. Is my interpretation correct?

Mr. WILLIS. Yes.

Mr. NORMAN. It is my understanding that the President's Committee saw certain difficulties and certain weaknesses in the private pension plan movement as it now exists and that they made certain recommendations for Federal action which they believed would correct those weaknesses.

If the weaknesses, such as lack of adequate vesting, are not to be corrected by Federal action, how could they be corrected?

Mr. WILLIS. I think, first speaking generally, many of the so-called weaknesses that the committee came up with were not what I would call weaknesses of a plan.

Commenting specifically on vesting, I would like to concur in what Mr. Siegfried said. Vesting is in essence portability. There is really no difference. In fact, it is the most practical form of portability that exists.

And the fact that about two-thirds of all pension plans already have vesting indicates that this is a very fast-moving trend.

In our company when we put in vesting in 1946, we were among the leaders in this. I say this only to indicate there weren't many others that had it. Now, already, less than 20 years later, two-thirds of the plans have it. Most of this has occurred during the last, say, 5 years.

So, here is a very fast moving trend, partly due to the competitiveness that exists in benefit plans and pension plans in particular, as well as a better and ever-improving recognition of the social status of pension plans. We have a fast moving trend in this area.

I think it is being put into plans to the extent and in the frequency that employers and employees can afford to do it. This is an expensive benefit when you put it in and there are times, of course, if you leave it out, you can establish a pension plan, which if it were required could not be done.

But certainly a pension plan is better than none at all.

Then the second step comes along later when the pension plan is established and the employer is better able to do something about his expenses, then he can move into the vesting area. I think the natural growth of the pension plans is such that this problem will be taking care of itself very rapidly and through the portability that exists in vesting. Whether it is in trustee or insurance plans, I think it is going to be solved by itself.

Mr. NORMAN. And you say a very important reason why it would be solved by itself is the competition for workers?

Mr. WILLIS. That is right, and the demand on the part of workers. In our own company, I think portability or vesting is a very minor element in restricting mobility of employees. We have, however, had demands from, particularly, people such as engineers who like to move. So we have a fairly good vesting provision.

In other words, the engineers wouldn't come with us if we didn't have a provision of this sort in our plan. They are looking for something that gives them some freedom of movement. They may not move for many reasons, but if we don't have it they will look somewhere else. So it is a natural competitive result.

Mr. NORMAN. Thank you, sir.

Senator RANDOLPH. Thank you, Mr. Willis, very much.

If you would care to provide the subcommittee with further information that you think might be helpful, we will be pleased to receive it and to make it a part of the record.

Mr. WILLIS. I would be delighted to be of any help that I can in the meantime, too.

Senator RANDOLPH. One phase of this subject on which we have received no oral testimony is extending private pension coverage to farmers. Two farm organizations have been invited to submit statements for the record on this phase of the subject, and their statements will be printed at this point in the record, in the order in which received.

(The statements referred to are as follows:)

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation appreciates the opportunity to present its views and recommendations with respect to the Self-Employed Individuals Tax Retirement Act. Farm Bureau is a voluntary organization of farm and ranch families with 1,647,455 members located in 2,751 counties in 49 States and Puerto Rico.

We have long recognized the inequity of the tax treatment which was accorded self-employed persons who desired to establish private retirement plans. Employer contributions to retirement plans have been tax deductible for some time and nontaxable to the employees until retirement benefits are actually received; however, the law discriminated against self-employed persons by requiring them to pay taxes on any income they set aside for retirement.

Farm Bureau responded to this situation by urging the enactment of legislation designed (1) to encourage the establishment of voluntary retirement plans by self-employed persons and (2) to extend to them some of the favorable tax deferral benefits already provided in the case of qualified retirement plans established by employers for their employees.

Congress recognized that discrimination did exist and enacted the Self-Employed Individuals Tax Retirement Act of 1962. This measure has tended to reduce the discrimination, but it has fallen demonstrably short of achieving its objective—especially with respect to farmers.

Farm Bureau policies for 1965 as adopted by the elected voting delegates last December state:

"The Self-Employed Retirement Act makes it possible for farmers and other self-employed persons to obtain a portion of the tax benefits that long have been available to many employees under employer-sponsored retirement plans. In the case of farmers, the benefits of this act are severely restricted by the requirement that only 30 percent of the earnings from self-employment involving the use of capital and labor shall be included in the taxpayer's earnings base.

"We urge that the law be amended to permit farmers to participate on a more equitable basis."

American agriculture is responsible for an important and large portion of the self-employed in our society. It is not consistent with national objectives to exclude farmers from the full benefits of legislation which was passed to reduce discrimination against the self-employed.

The technological revolution has combined with the initiative and accomplishments of American farmers to bring about the most efficient agriculture in the world. In order to cope with what many consider an overexpanded plant, numerous proposals have been and are being made for land retirement programs. While such programs can be helpful, they require considerable Federal expenditures and deal with only one factor of agricultural production. As fewer and fewer farmers are capable of producing a greater and greater amount of food and fiber, it seems obvious that we must make allowance for human retirement as well as land retirement.

For this objective we do not recommend Federal expenditures; we do recommend changes in the Self-Employed Individuals Tax Retirement Act which will afford farmers tax deferral treatment similar to that given the employed and self-employed in other sectors of our economy.

Under the Self-Employed Individuals Tax Retirement Act of 1962, most farmers are classified as "owner-employees." Owner-employees are authorized to contribute up to 10 percent of their earned income, but not more than \$2,500 per year, to a retirement plan and to claim a Federal income tax deduction for 50 percent of such contributions.

In the case of farmers, the benefits of this act are drastically limited by a restrictive definition of "earned income." If the earnings of an "owner-employee" are a joint product of personal services and invested capital, as is the case with most farmers, not more than the larger of \$2,500 or 30 percent of the taxpayer's earnings from self-employment may be treated as "earned income."

Thus, a farm operator whose earnings are the joint product of capital and labor must have a total farm income of more than \$8,333 if he is to be credited with an "earned income" of more than \$2,500 under the act. This means that most farm operators have an "earned income" of only \$2,500 per year for the purposes of the Self-Employed Individuals Tax Retirement Act. (See table 1.) Since contributions to retirement plans set up under the act are limited to 10 percent of "earned income," and only one-half of such contributions are deductible, the opportunity for farmers to participate obviously is severely limited.

A farmer with self-employed income of \$2,500 to \$8,333 may contribute only \$250 per year to an approved retirement plan and may claim a deduction of only \$125. A professional man with an income of \$8,333 from self-employment activities not requiring the use of capital would be permitted to contribute \$833 to a retirement plan and to claim a maximum deduction of \$416.50.

The 30-point rule fails to recognize either (1) the fact that the amount of capital associated with a given level of labor earnings varies widely with different types of farms, or (2) the fact that the percentage of a farm operator's income that is attributable to labor depends, in part, on the extent of his equity in the capital he is using.

These points are illustrated by tables 2 and 3. These tables show the family return from capital that appear, on the basis of a USDA study, to be associated with farm operator earnings of \$4,500 from labor and management in 29 types of farms.

Table 2 shows this information for farms where the family owns 100 percent of the capital utilized, and table 3 shows the same information for farms where the family owns only 50 percent of the required capital.

For example, on a Massachusetts dairy farm where the operator earnings total \$4,500, it is estimated that 67.8 percent of the family income from farming would be attributable to the operator's labor if the family had a 100-percent equity in the farm capital. However, with a 50-percent equity, total income would be lower, and 80.8 percent of the total would be attributable to the operator's labor.

It will be noted that the percentage of farm income attributable to labor varies from 24.3 to 79.3 with a 100-percent equity, and from 39.1 to 83.5 with a 50-percent equity. The portion of family income attributable to labor is as low as 30 percent in only 2 of these 38 examples. The median percentage of family income attributable to the operator's labor is 58 percent for operators with a 100-percent equity in farm capital, and 73.4 percent for operators with a 50-percent equity in farm capital.

It is clear from the foregoing that the 30-percent factor does not accurately or fairly portray the real "earned income" of most farmers. This arbitrary restriction works a special hardship on farmers whose incomes for the most part tend to vary substantially from one year to the next. For a retirement plan to meet the needs of agriculture, considerable flexibility as to annual contributions is necessary. It is not unusual for the vagaries of weather, plant and animal disease, pests, etc., to conspire to so limit a farmer's income as to make an annual contribution to a retirement fund impossible. The farmer should be able in the "good years" to make a contribution that is sufficient for an adequate long-term retirement program. Under the present law, this is not possible.

Let us compare a lawyer and a farmer, both of whom had net incomes of \$15,000. The lawyer would be permitted to invest \$1,500 (10 percent of earned income) in his retirement program; and would be authorized to deduct \$750 (50 percent of the contribution) for tax purposes. On the other hand, the farmer could contribute only \$450 (10 percent of 30 percent of his net income) to his retirement program; and would be authorized to deduct only \$225 for tax purposes.

As originally passed by the House of Representatives, the bill which became the Self-Employed Individuals Tax Retirement Act did not require that "earned income" be computed at 30 percent of the net income from businesses which

required both capital and personal services. We believe that the act should be amended to remove this requirement. We do not believe it would create any loopholes in the tax laws since retirement contributions would still be limited to 10 percent of earned income, or \$2,500, whichever is less.

The Self-Employed Individuals Tax Retirement Act was necessary if equitable tax treatment was to be accorded the self-employed as compared to the employee. Removal of the artificial definition of "earned income" is necessary now if we are to bring equality of tax treatment to the self-employed who must invest capital as compared to the self-employed who do not have to invest capital.

TABLE 1.—Income and production expenses per farm of farm operators from farming by value of sales classes, 1963

| | Number of farms | Realized gross farm income | Production expenses | Realized net farm income |
|---------------------------|-----------------|----------------------------|---------------------|--------------------------|
| Farms with sales of— | | | | |
| \$20,000 and over..... | 384,000 | \$56,154 | \$45,974 | \$10,180 |
| \$10,000 to \$19,999..... | 594,000 | 16,375 | 10,168 | 6,207 |
| \$5,000 to \$9,999..... | 609,000 | 8,831 | 5,100 | 3,731 |
| \$2,500 to \$4,999..... | 463,000 | 4,711 | 2,374 | 2,337 |
| Less than \$2,500..... | 1,523,000 | 1,896 | 867 | 1,029 |

Source: Farm Income Situation, November 1964.

TABLE 2.—Family farm income, 29 farms programed for operator earnings of \$4,500 per year, assuming 100-percent equity in farm capital, 1959

| Type of farm and area | Family returns for capital assuming 100-percent equity ¹ | Operator earnings | Total family income ¹ | Percent attributable to operator labor |
|--|---|-------------------|----------------------------------|--|
| Dairy: | | | | |
| Massachusetts..... | \$2,135 | \$4,500 | \$6,635 | 67.8 |
| Northern New Jersey..... | 2,687 | 4,500 | 7,187 | 62.6 |
| Southeastern Pennsylvania..... | 2,480 | 4,500 | 6,980 | 64.5 |
| Eastern Wisconsin..... | 3,602 | 4,500 | 8,102 | 55.5 |
| Southeastern Minnesota..... | 3,254 | 4,500 | 7,754 | 58.0 |
| Central Utah..... | 3,530 | 4,500 | 8,030 | 56.0 |
| Willamette Valley, Oregon..... | 3,256 | 4,500 | 7,756 | 58.0 |
| South Carolina Piedmont..... | 1,636 | 4,500 | 6,136 | 73.3 |
| Beef systems: | | | | |
| Ranching: | | | | |
| South-central Oklahoma..... | 14,021 | 4,500 | 18,521 | 24.3 |
| Northern Nevada..... | 5,349 | 4,500 | 9,849 | 45.7 |
| Farming, western Tennessee..... | 2,466 | 4,500 | 6,966 | 64.6 |
| Fattening, northeastern Colorado..... | 3,601 | 4,500 | 8,101 | 55.5 |
| Hog-beef, southern Iowa..... | 3,535 | 4,500 | 8,035 | 56.0 |
| Hog, west central Illinois..... | 4,839 | 4,500 | 9,339 | 48.2 |
| Poultry, eastern Connecticut..... | 1,485 | 4,500 | 5,985 | 75.2 |
| Wheat: | | | | |
| North-central Montana..... | 9,521 | 4,500 | 14,021 | 32.1 |
| Palouse area, Washington..... | 3,642 | 4,500 | 8,142 | 55.3 |
| Wheat-sorghum, northwest Kansas..... | 6,745 | 4,500 | 11,245 | 40.0 |
| Cotton-wheat, rolling plains area, Oklahoma..... | 11,257 | 4,500 | 15,757 | 28.6 |
| Cotton: | | | | |
| Upper coastal plain, South Carolina..... | 2,634 | 4,500 | 7,134 | 63.1 |
| Mississippi Delta..... | 3,040 | 4,500 | 7,540 | 59.6 |
| High Plains, Texas..... | 1,756 | 4,500 | 6,256 | 71.9 |
| San Joaquin Valley, California..... | 4,438 | 4,500 | 8,938 | 50.3 |
| Corn, east central Illinois..... | 6,156 | 4,500 | 10,656 | 42.2 |
| Rice, Grand Prairie, Arkansas..... | 1,983 | 4,500 | 6,483 | 69.4 |
| Tobacco: | | | | |
| Central coastal plain, North Carolina..... | 1,174 | 4,500 | 5,674 | 79.3 |
| North-central Kentucky..... | 1,385 | 4,500 | 5,885 | 76.5 |
| Potato-general, southern Idaho..... | 2,840 | 4,500 | 7,340 | 61.3 |
| Apple, central Washington..... | 4,694 | 4,500 | 9,194 | 48.9 |

¹ Assumes a 5-percent rate of interest on investment capital.

Source: "Resource Requirements on Farms for Specified Operator Incomes," Agricultural Economic Report No. 5, Farm Production Economics Division, Economic Research Service, U.S. Department of Agriculture, revised November 1964.

TABLE 3.—Family farm income, 29 farms programed for operator earnings of \$4,500 per year, assuming 50-percent equity in farm capital, 1959

| Type of farm and area | Family returns for capital assuming 50-percent equity ¹ | Operator earnings | Total family income ¹ | Percent attributable to operator labor |
|--|--|-------------------|----------------------------------|--|
| Dairy: | | | | |
| Massachusetts..... | \$1,068 | \$4,500 | \$5,568 | 80.8 |
| Northern New Jersey..... | 1,344 | 4,500 | 5,844 | 77.0 |
| Southeastern Pennsylvania..... | 1,240 | 4,500 | 5,740 | 78.4 |
| Eastern Wisconsin..... | 1,801 | 4,500 | 6,301 | 71.4 |
| Southeastern Minnesota..... | 1,627 | 4,500 | 6,127 | 73.4 |
| Central Utah..... | 1,765 | 4,500 | 6,265 | 71.8 |
| Willamette Valley, Oregon..... | 1,628 | 4,500 | 6,128 | 73.4 |
| South Carolina Piedmont..... | 818 | 4,500 | 5,318 | 84.6 |
| Beef systems: | | | | |
| Ranching: | | | | |
| South-central Oklahoma..... | 7,011 | 4,500 | 11,511 | 39.1 |
| Northern Nevada..... | 2,675 | 4,500 | 7,175 | 62.7 |
| Farming, western Tennessee..... | 1,233 | 4,500 | 5,733 | 78.5 |
| Fattening, northeastern Colorado..... | 1,801 | 4,500 | 6,301 | 71.4 |
| Hog-beef, southern Iowa..... | 1,768 | 4,500 | 6,268 | 71.8 |
| Hog, west-central Illinois..... | 2,420 | 4,500 | 6,920 | 65.0 |
| Poultry, eastern Connecticut..... | 742 | 4,500 | 5,242 | 85.8 |
| Wheat: | | | | |
| North-central Montana..... | 4,761 | 4,500 | 9,261 | 48.6 |
| Palouse area, Washington..... | 1,821 | 4,500 | 6,321 | 71.2 |
| Wheat-sorghum, northwest Kansas..... | 3,373 | 4,500 | 7,873 | 67.2 |
| Cotton-wheat, Rolling Plains area, Oklahoma..... | 6,629 | 4,500 | 10,129 | 44.4 |
| Cotton: | | | | |
| Upper coastal plain, South Carolina..... | 1,317 | 4,500 | 5,817 | 77.4 |
| Mississippi Delta..... | 1,625 | 4,500 | 6,025 | 74.7 |
| High Plains, Texas..... | 878 | 4,500 | 5,378 | 83.7 |
| San Joaquin Valley, California..... | 2,219 | 4,500 | 6,719 | 67.0 |
| Corn, east-central Illinois..... | 3,078 | 4,500 | 7,578 | 69.4 |
| Rice, Grand Prairie, Arkansas..... | 992 | 4,500 | 5,492 | 81.9 |
| Tobacco: | | | | |
| Central coastal plain, North Carolina..... | 587 | 4,500 | 5,087 | 88.5 |
| North-central Kentucky..... | 692 | 4,500 | 5,192 | 86.7 |
| Potato-general, southern Idaho..... | 1,420 | 4,500 | 5,920 | 76.0 |
| Apple, central Washington..... | 2,347 | 4,500 | 6,847 | 65.7 |

¹ Assumes a 5-percent rate of interest on investment capital.

Source: "Resource Requirements on Farms for Specified Operator Incomes," Agricultural Economic Report No. 5, Farm Production Economics Division, Economic Research Service, U.S. Department of Agriculture, revised November 1964.

NATIONAL FARMERS UNION,
March 12, 1965.

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

DEAR SENATOR RANDOLPH: The Farmers Union, which represents three-fourths of a million people who live on farms, is concerned about the adequate protection of pensions and pension rights. The reason is simply that more and more of our farm families are having to turn to employment in nonfarm occupations either on a part-time basis or during a portion of the year in order to make ends meet. Farm income has been going down for far too many family farmers. In order to make up the difference, some farmers work during the winter months in plants and stores and at other jobs. In other cases, wives and other members of the farm family must seek employment outside of agriculture to supplement what the farm makes. Some are able to get good jobs in good paying industries. Others aren't quite so lucky.

Many of these people will only work away from the farm when farm prices and farm conditions are poor. Hence, many never achieve any vested interest in pension plans in the jobs at which they work. Even those who work at a job for 2 or 3 years running find that practically all vested pension rights are based on 7 to 10 years of service.

Some families work every year for several months—only to find that this does not qualify them for vested rights in pension plans. Also, most of the jobs which farmers and farm family members hold are those in small shops and

industries where often they do not have adequate pension plans, if at all. Fortunately, social security payments both as an employed worker and as a self-employed worker on the farm are there when they are retired.

Many of these small plants and shops, too, fold up, merge, or go bankrupt and, in the process, any pension rights which they might have possibly had, also disappear. For these reasons, the Farmers Union Senior Member Council, which concerns itself with these matters, is in favor of greater protection for pension rights—particularly in vesting provisions. We are concerned about the vast economical power of pension plans and the fact that many pension plans have gained vast sums through investments while still paying out exceedingly meager plans.

We urge closer inspection of pension plans by the Federal Government.

We endorse the proposal for reinsurance of all pension plans with lower insurance rates for multiple employ.

We believe that private pensions have not and cannot carry the major responsibility for retirement income.

We endorse the concept of the market basket social security to provide not a base but a minimum decent standard of living in retirement.

Respectfully,

Dr. BLUE CARSTENSON,
*Director, Senior Member Council,
National Farmers Union.*

(Subsequently the following letter was received in response to a request for additional information on questions raised by the above letters.)

DEPARTMENT OF AGRICULTURE,
Washington, April 2, 1965.

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

DEAR SENATOR RANDOLPH: This is in reply to your letter of March 24 concerning pension arrangements for farmers and the contribution of retirement to solution of agricultural problems.

Farmers who have reached or have nearly reached retirement age form a vast group. Nearly 40 percent of all farmers in the United States have passed their 55th birthday. A great many are well beyond normal retirement age, with more than 15 percent of all farmers over 65.

More than a million of the farmers over 55 operate farms with sales less than \$10,000 per year. Few of them would find it possible to participate in voluntary pension plans. They earn so little that they could contribute little to such a program. Also, three-quarters of a million rural nonfarm families are headed by persons over 55 and have very low incomes.

Another possibility for encouraging earlier retirement is to keep a part of the released resources out of production, at least for several years while surplus production problems persist. We have under consideration a cropland adjustment program with special provisions to assist elderly farmers who wish to retire gradually from farming while still continuing to live on their farms. Past experience suggests that voluntary long-term cropland adjustment programs can have a pronounced impact on retirement. Farmers receive payments for taking land out of production for a period of years and putting it into conserving uses. This has been found especially attractive as an inducement to elderly farmers to retire early.

It has become possible to meet the demand for agricultural products with fewer farmers. In recent years, most farm youths have been going into nonfarm careers. With few young people entering farming, the average age of those remaining in farming has been creeping up, and promises to continue to do so. Thus both the present age distribution of farmers and the tendency toward surplus agricultural production arise to a great extent from the continued introduction of improved methods of production—better and larger machinery, expanded use of fertilizers, new pesticides, and improved seeds.

More rapid retirement encouraged by attractive private pension arrangements would provide somewhat more farming opportunities for younger people. But most of today's active farmers would also compete very strongly for the land and other resources retiring farmers would release.

More rapid retirement would not contribute materially to solution of farm surplus problems even though it could alleviate the low-income problem facing many farmers. In fact, if farms became larger and were operated by younger men, the rate of increase in production might be speeded up.

The substantial participation of farmers in the social security program indicates that there is a potential for inducing earlier retirement. But the fact that many continue to farm past the age of 65 indicates that more attractive plans are needed. Pension plans based on voluntary contributions of farmers have promise. However, they probably could not be made sufficiently attractive to have much impact unless present tax laws were changed. Only small numbers take advantage of the present tax exemptions permitted for pension plans of the self-employed. If attractive to farmers, this type of plan could make a contribution to releasing resources to other farmers because there would likely be greatest participation among those farmers who have relatively high sales and who control much land. There are close to 1 million farms with sales of over \$10,000 worth of products. These larger farms account for most of the agricultural production of the country. The concentration of older farmers in this higher sales group is not quite as great as for all farmers referred to above, but even for the high sales group the percentage of older farmers is substantial. About 25 percent of the operators of these farms have passed their 55th birthday, and between 5 and 10 percent have passed their 65th birthday. These data suggest that a program designed to be attractive to older farmers on larger farms would allow an impressive fraction of farm resources to become available to younger operators, including a small number of new farm operators. But we should expect a large part of the resources to be absorbed by enlargement of existing farms.

Your committee might be interested in reviewing the experience of the Netherlands, which relies on programs to induce early retirement of farmers as a major instrument of achieving needed structural adjustments in the agriculture of the country.

If we can be of service to the committee, please let us know.

Sincerely yours,

JOHN A. SCHNITKER,
Director, Agricultural Economics.

(Pursuant to invitation to testify, the following statement was received for the record.)

PREPARED STATEMENT OF LLOYD E. SKINNER, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. Chairman and members of the committee, the National Small Business Association appreciates the opportunity to submit this statement to your committee. The small business segment of the economy has a deep and abiding interest in the establishment and successful administration of private pension coverage, but it should be noted that pension coverage is far more difficult in the small business community than among larger firms for very practical reasons. Although better than 50 percent of the economy is supported by smaller business operations, the impact of Federal taxes, a negative Federal tax policy toward pension benefits, and high costs of administration frequently constitute insurmountable barriers to the establishment of small business pension plans.

We have studied the report of the President's Committee on Corporate Pension Plans, as well as the questions circulated by this subcommittee for comment by responding witnesses.

Frankly we are concerned, not so much by plain words, as by the implications suggested between the lines. There seems to be building behind the scenes an official attitude which is out of harmony with traditional concepts of the roles which ought to be played by business and by government in the development of a sound economy. Perhaps we need to review the basis of our prosperity and ask ourselves some searching questions concerning the economic cost of increasing Federal influence on the factors which determine whether or not our productive machinery can operate at a profit.

For instance, are we completely aware that under our present monetary policy the value of the American dollar depends almost solely on the free functioning of our productive machinery?

Have we forgotten that the might of our Government flows from the successful operation of our business economy, and not the other way around?

Are we aware that the continued supremacy of America is absolutely dependent on our continued dedication to virtues and principles which are just as valid today as they were when the Nation was founded?

Are we gradually succumbing to the socialistic concept that men can be reduced to common denominators—that one is the equal of another in any respect whatever except in basic political rights as a citizen?

Have we fully faced the fact that in spite of the huge burden on our economy, our vast social security system does not provide even minimal protection, especially in view of the steadily declining purchasing power of the dollar?

Why then is there any doubt whatever about the desirability and the necessity of private pension plans which provide for the nonproductive years of those who have made their contribution to the economy?

What is behind the official attitude which appears to regard the business cost of private pension plans as a tax loophole?

At the present stage of our economic and social progress is the employer's contribution to a pension fund any less legitimate as a business expense or any less valuable to employees than the payment of wages, or any less valuable to the Government in minimizing the need for further Federal responsibility?

There is in the small business community an increasing surge of interest in the development of private pension plans; but there are many complications and difficulties in trying to devise a simple plan of wide scope which can avoid the expensive ramifications of IRS approval on an individual basis and at the same time distribute the cost of administration to an extent that would make pension plans feasible for even the very small corporations and proprietorships. The unreality of the restrictions of the present law relating to the self-employed is also a major obstacle to progress in the private pension sector. The obvious discrimination against the self-employed and their employees cannot be justified on any rational basis, and appears to be due, partly at least, to a misunderstanding of the rationale of the tax treatment accorded to corporations. There is no distinction in terms of economic and social value to the economy as between the incorporated and unincorporated form of business enterprise—nor should there be any tax discrimination as between the two forms of business activity.

For many years we have supported the Smathers-Keogh bill. But, as this committee knows, this legislation, as passed, offered little incentive to its use. And contrary to Treasury estimates, very few of the self-employed have acted under the present law. We, therefore, strongly support the passage of the present H.R. 10 which will do much to make possible the extension of pension coverage among the self-employed.

For the past several years we have been actively studying the pension possibilities of small business, and we are convinced that even spurred by favorable legislation, progress among the smaller firms is going to be slow and will require education of small business as well as effective cooperation between business and Government.

For this reason we believe that it would be almost fatal to attempt, at this stage of progress, establishment of broad scale standards with respect to vesting, coverage, benefits, or any other phase of private pension development. It will be found that unique circumstances exist in almost every type of business and that necessary adjustment to these conditions will necessarily result in tailored plans. This is to say that equitable coverage under one set of facts may be obviously impractical or even impossible in another type of business. It does not follow that resulting disparities as between plans, may be classified generally as "serious inequities" without the most careful study of the reasons behind the adoption of the particular plan.

Furthermore, history has clearly demonstrated that the standards and limitations proposed even 10 years ago would have proven shortsighted under today's conditions.

With respect to the specific questions, we believe that it is not only wise and proper for the Federal Government to encourage private pension plans, we are convinced that such a course is necessary to further the health of the economy and to protect the Government against future responsibility in this area (question No. 1).

The foregoing comments also cover question No. 2 as to the advantages of private pension funds to the employer, the employee, and the Federal Government.

With respect to question No. 3 we do not think there is any "loss" resulting from the tax position of private pensions. Viewed on a long-range basis and in the light of the total effect on the economy, pensions add to the flow of business activity which indirectly benefits the Government to a far greater extent than the immediate tax concessions.

Thus in response to question No. 4 tax encouragement of private pension plans is more in the nature of a sound investment in the future and in the economic stability of the country.

Question No. 5 we believe has been answered by the above comments.

We have no knowledge or information on which to base an answer to questions Nos. 6, 7, 9, 11, and 12.

With respect to question No. 8 we concur with the comments of Prof. Carl H. Fischer. We also concur with his views on questions Nos. 10, 13, 15, and 16, and his concluding summary.

As to question No. 14 it would appear that extension of coverage to professional service corporations and professional associations, and taxing them as corporations would have the result of greatly increasing private pension coverage, although this is purely an opinion.

With respect to questions Nos. 17 and 18 we have no way of assessing the answers to these questions except to the extent answered by the foregoing general statements and opinions.

We greatly appreciate the opportunity to submit this statement for the record.

Senator RANDOLPH. I would like to say also to those of you who sat through these hearings, and to others who have dropped in very casually, that since you have a real interest in the subject matter of these hearings, I want Mr. Norman and Mr. Miller to have the privilege of receiving your reactions to the testimony that has been presented, if you desire to talk with them about it.

Thank you very much.

We will close the hearing at this time.

(Whereupon, at 11:20 a.m., the hearing was closed.)

APPENDIX

LAMBERT M. HUPPELER Co., CONSULTANTS,
New York, N.Y., March 4, 1965.

Re pension hearings.

Senator JENNINGS RANDOLPH,
The Senate Office Building,
Washington, D.C.

DEAR SENATOR: The recent announcement of hearings by your committee concerning certain aspects of private pension plans was received with much interest.

May I respectfully suggest that the two areas mentioned for immediate consideration (the salaried-employee-only plan option and the present 5-year eligibility provision) are, in practice, presently of little significance. If your committee could secure from the Internal Revenue Service a summary of the plans approved during 1964, I believe that you would find few, if any, new plans covering salaried employees only or with a 5-year eligibility requirement. These rules are, of course, of considerable significance to the older larger pension plans and consideration should, I believe, be given to their problems before any change in these rules is recommended.

I would hope that, in line with the Presidential Committee's recommendations with regard to the salaried-only plan, consideration be given to allowing plans for salaried employees only (or employees other than bargaining-unit employees) where other employees are represented by a union. Salaried-only plans should be allowed regardless of whether the union employees have a pension plan in effect. The fact that a represented group does not have a pension or profit-sharing plan should be accepted as evidence that their representatives have elected direct wage increases or other benefits in place of the retirement plan coverage. Since an employer cannot cover such employees under a salaried employee plan without bargaining, it is not fair to limit the employer's ability to provide benefits for his other employees. In considering the question of comparable union and salaried benefits, I believe all of the welfare and pension benefits as well as wage differentials should be considered and not just the union pension benefit.

Please accept these thoughts in the cooperative spirit in which they are intended. I would appreciate it if you would add my name to your mailing list for a copy of your committee's releases and ultimate report.

Thank you and for your interest and consideration.

Sincerely,

HAROLD A. CLARK.

THE PROCTER & GAMBLE Co.,
Cincinnati, Ohio, March 19, 1965.

HON. JENNINGS RANDOLPH,
Chairman, Subcommittee on Employment and Retirement Income, Special Committee on Aging, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: We have been following with interest the inquiry your committee is conducting into ways to make private pension plans available to those who are not now covered. We heartily approve the announced intention of your study: " * * * to chart the way to improve Federal laws and policies to insure coverage of more Americans by private pension plans."

Your interest in your study grows out of the fact that the Procter & Gamble Co., as you may know, has had a profit-sharing program ever since 1887 which provides the basic retirement benefits for its employees.

We understand that one of the documents which has come before your committee for consideration is the report of the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs.

We recognize the great amount of intelligent effort which was devoted to the study and report of the President's Committee. It seems almost unnecessary to say that the report contains many proposals which merit careful consideration by all who are interested in the continuation and expansion of private retirement programs.

However, in the light of our long experience with plans designed to provide retirement income, we respectfully suggest to your committee that certain of the recommendations in the President's Committee report would be contrary to the goal of your study—extended coverage of private retirement plans.

We want to comment directly on just three of the recommendations made by the President's Committee. The fact that we do not comment on the other provisions does not indicate agreement or disagreement with them. Some of the recommendations—for instance, those covering funding and vesting—are already accommodated by Procter & Gamble's present plans. Other recommendations concern provisions with which we have had no firsthand experience and therefore we prefer not to comment.

Our comments will be confined to the Committee's recommendations (1) that uniform coverage be provided for all employees of a company; (2) that a dollar ceiling on contributions be imposed; and (3) that present provisions regarding lump-sum distributions of retirement benefits and the tax treatment of distributions of employers' securities be eliminated.

(1) The President's Committee has recommended that the option to have retirement plans cover only salaried or clerical employees be eliminated unless special circumstances can be shown. The principle of nondiscrimination among groups which prompted this recommendation is, of course, acceptable and sound. In many cases, however, practical considerations make it necessary to establish plans for specified groups. For instance, a company may have more than one plan because of Federal law, such as the National Labor Relations Act, which makes it almost impossible for any employer to improve retirement benefits without bargaining the issue with unions. It is common knowledge that on numerous occasions when retirement plans for salaried employees have been offered to hourly employees in the collective bargaining process they have been rejected.

Requiring uniform coverage of all employees in a company would destroy much of the flexibility which an employer needs to innovate and improve private retirement plans—and which has benefited both hourly and salaried employees over the years. It should also be kept in mind that adequate statutory safeguards already exist to prevent discrimination in favor of officers, directors, supervisors, or other higher salaried employees.

(2) The Committee's proposal for a dollar ceiling on contributions for commensurate benefits, in our judgment, is also unwise. Present law provides adequate safeguards against abuse by requiring qualified private retirement plans to operate in a nondiscriminatory manner and by limiting the maximum amounts contributed to such plans. Differences in the benefits distributed reflect differences in salary levels which in turn are produced by differing responsibilities of the employees. We do not consider it inappropriate or socially undesirable for an employee receiving a salary over his working life of \$50,000 per year to receive higher retirement benefits than an employee averaging \$10,000 per year over his working career, so long as the benefits they receive bear an equitable relationship to preretirement pay.

(3) The President's Committee has also recommended elimination of present provisions covering lump-sum distributions of retirement benefits and the tax treatment of distributions of employer securities to employees. The tax treatment of qualified private retirement plans has been under almost continuous congressional study since 1958. Most recently this subject was explored in public hearings in the 88th Congress. Your Committee is doubtless aware of the many reasons advanced by witnesses before the House Ways and Means Committee and the Senate Finance Committee as to the desirability of retaining present tax treatment in this area. We will not belabor this point, adding only that changes in this area would seriously affect private retirement plans. We attach testimony on this subject submitted by Procter & Gamble to the last Congress which may be useful to you.

We share your Committee's belief that private retirement plans have provided and will continue to provide valuable means of assuring adequate retirement income. We believe it advances the public interest to extend plans to an increasing segment of the population. We wish your Committee well in its efforts to find ways of stimulating that growth.

Yours very truly,

NEIL McELROY.

SELBACH & Co.,
San Francisco, Calif., March 8, 1965.

Hon. JENNINGS RANDOLPH,
U.S. Senator, Senate Office Building,
Washington, D.C.

DEAR SENATOR RANDOLPH: I understand that you are looking for ways to improve Federal laws and policies to assure coverage of more Americans by private pension plans.

I am an individual employer with five employees, but find it practically impossible to provide a pension plan for my employees, which I would like to do, under the present Federal laws without incorporating.

It seems to me that there is no reason why individual small employers should not have the same tax advantages in providing pensions that corporations have.

Thank you in advance for your consideration of this matter.

Yours sincerely,

W. T. SELBACH.

THE NATIONAL COUNCIL ON THE AGING,
New York, N.Y., January 1965.

ISSUES AND POLICIES CONCERNING THE INCOME POSITION OF OLDER PERSONS¹

THE BASIC ISSUES

Of the 18 million people now 65 and older, significant proportions receive income too low to permit independent living by any reasonable standard. Even if older individuals were to supplement current income by prorating financial assets over the remaining life expectancy, more than a third of all aged couples, and about two-thirds of the nonmarried would still have insufficient income to attain the "modest but adequate" budget standards developed by the Bureau of Labor Statistics.

Persons retiring in the future can be expected to be better off economically—how much will depend in large measure on ability to continue in gainful employment until eligibility for full retirement benefits.

But no matter how optimistic the outlook for future generations of the aged, the Nation is today faced with the reality of 18 million citizens already past 65 who, as a group, have inadequate incomes and

¹This insertion was referred to in Dean Schottland's testimony. See pp. 35 and 37.

insufficient protection against the heavy medical costs of old age. With expanding productivity, our economy will permit ever higher standards of living. Our 18 million aged, however, will not automatically share in this improvement. Unless specific action is directed toward sharing our expanded productivity with people already too old to work, their economic condition can be expected to decline in the years ahead when medical needs increase and financial assets are eaten away. For the group of 18 million, the problem of low income is persistent, not temporary.

The Retirement Income Subcommittee has therefore undertaken to define both the immediate and long-range issues relating to the income position of the elderly.² While emphasis has been placed on the immediate and more specific issues, the subcommittee recognizes that there are certain basic public policy questions which, though still not clearly resolved, will shape the decisions on the specific issues. Among the basic policy questions are these:

What constitutes an adequate level of income for retired persons? One widely used measure is the "minimum but adequate" level developed by the Bureau of Labor Statistics, estimated to cost about \$2,500 for a retired couple and \$1,800 for an aged individual in autumn 1959. The Social Security Administration has suggested that \$2,800 would be a more reasonable figure for the couple in order to allow for the heavier transportation costs of homeowners and the costs of health insurance and other medical expenses encountered by the aged even when in reasonably good health. Other students have pointed to what they considered serious deficiencies in the budget; not quite an egg a day per person for the table and for use in cooking, replacement of the man's topcoat only every ninth year, and no allowance for special medical costs or other services. There is thus still no generally agreed upon yardstick against which to assess the income position of the older population.

What part in attaining an adequate level of income should be played by governmental programs and what by voluntary group action and individual effort? All three elements are unquestionably essential but there is no agreement on how large a share should be assumed publicly and how much left to private endeavor. Nor is there agreement as to the proper interrelationships of the two governmental programs of social insurance and public assistance. Should the social insurance program provide only a minimum floor of protection, leaving to public assistance the job of providing supplementary income for those who do not have private resources? Or should the social insurance program endeavor to underwrite a guaranteed level for all aged persons, and, if so, where should this level be pegged?

Of the public segment, what share should be financed through payroll taxes and what through general revenues? Obviously, the answer to this question is inseparable from the question of the relationship of public assistance, financed by general revenues, to social insurance, financed by payroll taxes. But there is another dimension to this issue: Increasing support is emerging for the use of a general revenue contribution in the long-range financing of the social insurance program. Advocates point out that this would not only introduce a more progres-

² To assist in this undertaking, current information has been pulled together in a working document. Background Facts on the Income Position of Older Persons, December 1964.

sive form of taxation, but provision for future use of general revenues would make possible immediate benefit improvements without corresponding increases in payroll taxes levied on workers and their employers.

What are the consequences—to the economy as well as to the aged individual—of tax exemptions and various other subsidies that recognize the inadequacy of income without providing a direct increase in retirement benefits or other income? The Federal income tax law and many State and local tax laws provide special treatment for aged persons. Around the country, there are also myriad examples of other efforts—half-price bus fares and movie tickets, reduced rates on eyeglasses, surplus food programs—to help older people stretch incomes that are inadequate. These piecemeal efforts, beneficial as they may be to the older person who needs the service that happens to be provided, fail to come to grips with the basic problem of inadequacy of income. The economy as well as the individual would gain, it is argued, by providing older people with sufficient income so that they could participate freely as first-class consumers.

What improvement in income can be expected for future generations of aged persons? Unquestionably, the economic position of the retired population will continue to improve. Nearly all will qualify for social insurance benefits and these benefits will reflect the relatively high wages of recent years; more of them will have private pensions and other forms of savings. But optimism about the future must be tempered by the recognition that many older workers are having difficulty in holding onto their jobs until retirement age; an increasing number may have to settle for permanently reduced retirement benefits after having used up savings while unemployed prior to eligibility.

Lack of agreement on the answers to these general public policy questions is reflected in the debate around the specific issues. For example, anyone who predicts great improvement for the future is inclined to view the problem of low income as essentially a transitional problem, more suitable for handling through the public assistance approach, than through social insurance which involves a continuing commitment.

MAJOR SPECIFIC ISSUES

Following are what appear to be the major specific issues.

* * * * *

(12) Is legislation needed to encourage the expansion and strengthening of private pension plans?

Private pension plans represent a tremendous potential for raising the level of private resources available during retirement. Proposals for extending and increasing their protection are thus clearly of public concern and constitutes one of the major issues relating to retirement income.³

The issue 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 would tend to stifle healthy growth?

Although private pension plans are a relatively new development, nearly 25 million workers are now covered and the number is estimated to rise by 1980 to 42 million (60 to 65 percent of all employees of private, nonfarm establishments). The aged beneficiaries of the plans, now fewer than 2½ million, are expected to number 6.6 million by 1980, or about 30 percent of the population then 65 and older. Thus, even though a major portion of the maturing process of these private plans will have taken place by 1980, the OASDI program will still be providing the only formal retirement protection for the great majority of persons past 65.

In an effort to stimulate further the development of private plans and to guard against losses of protection, answers are now being sought to such specific questions as these:

(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?

³ While the issue is of immediate concern, any action which is taken now to maximize the protection of private pension plans will have little or no impact on the incomes of persons who are already old.

(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?

