

The revenues of the Federal Government, and other units of government in certain instances, are lower than they would otherwise be as a result of not taxing currently as income to the covered employee those contributions which the employer makes to pension programs. In 1965, such contributions exceeded \$10 billion, of which two-thirds were supplied by private and one-third by public employers. This figure does not accurately reflect the true situation because the Federal civil service and some State systems are greatly underfunded; that is, the employer's contribution substantially understates the growth in the employee's equity in the program. The extreme case, of course, is the retirement program for members of the armed services under which benefits are paid as current budgetary expenses. The member earns a right to retirement benefits, but that equity is not recognized until he starts to draw them. The same is true of additional billions of employer contributions to a wide range of health and insurance benefit programs.

The figure which appears in the flow-of-funds accounts as retirements saving is, we should constantly bear in mind, only the increase in assets held in trust funds or as offsets to life insurance reserves. This is not necessarily the same figure as the present value of pension claims accrued during a year after discounting for mortality and turnover factors. What the real figure is no one knows, but, particularly in public programs, there is a very substantial understatement. It is clear, however, that we are measuring only financial claims which are specifically recognized, rather than the growth of individuals' pension equities.

Whatever the true magnitudes, there is a partial offset in that pension benefits received as a result of employer contributions are taxed as income, with the exception of OASI benefits, which are, of course, not taxed. The offset is reduced by the more favorable tax treatment of persons over 65 and the fact that lower rates are applicable on the average for the person no longer actively employed.

Thus we can say that the growth of public and private pensions has eroded the revenue base for taxation based upon income. The simplest illustration is the recent trend in some State and local government retirement programs to take over a portion of the employee's contribution instead of increasing salaries. The same result is achieved by increasing benefits without changing the employee's contribution rate.

Another important tax exemption is that of the income earned by a pension fund. The amount of this untaxed income has, of course, grown rapidly as public and private systems have accumulated assets. Exclusive of Federal programs, such untaxed earnings are about one-half of the employer contributions.

Substantial but unmeasured reductions in Federal, State, and local expenditures are made possible by the flow of pension benefits. We have observed the partial displacement of old-age assistance by social security as an example. Given a target of well-being sought for the aged, the existence of pension benefits may afford governmental units substantial economies in their necessary outlays for supporting housing projects, other community facilities, and agencies.

The effect on Government saving is difficult to determine, as Cagan has pointed out. It seems doubtful that this one element in the tax