

Y4
.p 84/10

90-25

RETIREMENT FINANCING

GOVERNMENT

Storage

(Part I)

HEARINGS

BEFORE THE

COMMITTEE ON RETIREMENT, INSURANCE,
AND HEALTH BENEFITS

OF THE

COMMITTEE ON
POST OFFICE AND CIVIL SERVICE
HOUSE OF REPRESENTATIVES

NINETIETH CONGRESS

FIRST SESSION

ON

H.R. 10912

A BILL TO AMEND CHAPTER III OF CHAPTER 83 OF
TITLE 5, UNITED STATES CODE, RELATING TO CIVIL
SERVICE RETIREMENT

NOVEMBER 8, 9, 14, AND 15, 1967

Serial No. 90-25

Printed for the use of the Committee on Post Office and Civil Service



U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1967

87-153

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION



COMMITTEE ON POST OFFICE AND CIVIL SERVICE

THADDEUS J. DULSKI, New York, *Chairman*

DAVID N. HENDERSON, North Carolina
ARNOLD OLSEN, Montana
MORRIS K. UDALL, Arizona
DOMINICK V. DANIELS, New Jersey
ROBERT N. C. NIX, Pennsylvania
JOE R. POOL, Texas
WILLIAM J. GREEN, Pennsylvania
JAMES M. HANLEY, New York
CHARLES H. WILSON, California
JEROME R. WALDIE, California
RICHARD C. WHITE, Texas
WILLIAM D. FORD, Michigan
LEE H. HAMILTON, Indiana
FRANK J. BRASCO, New York

ROBERT J. CORBETT, Pennsylvania
H. R. GROSS, Iowa
GLENN CUNNINGHAM, Nebraska
EDWARD J. DERWINSKI, Illinois
ALBERT W. JOHNSON, Pennsylvania
JAMES T. BROYHILL, North Carolina
DANIEL E. BUTTON, New York
WILLIAM L. SCOTT, Virginia
PHILIP E. RUPPE, Michigan
JAMES A. McCLURE, Idaho
FLETCHER THOMPSON, Georgia

CHARLES E. JOHNSON, *Staff Director*

B. BENTON BRAY, *Associate Staff Director*

JOHN H. MARTINY, *Counsel*

WILLIAM A. IRVINE, *Assistant Staff Director*

THEODORE J. KAZY, *Senior Staff Assistant*

SUBCOMMITTEE ON RETIREMENT, INSURANCE, AND HEALTH BENEFITS

DOMINICK V. DANIELS, New Jersey, *Chairman*

DAVID N. HENDERSON, North Carolina
JOE R. POOL, Texas
WILLIAM J. GREEN, Pennsylvania
JAMES M. HANLEY, New York

JAMES T. BROYHILL, North Carolina
ALBERT W. JOHNSON, Pennsylvania
FLETCHER THOMPSON, Georgia

Ex Officio Voting Members

THADDEUS J. DULSKI, New York

ROBERT J. CORBETT, Pennsylvania

CONTENTS

Hearings held on—	Page
Wednesday, November 8, 1967-----	1
Thursday, November 9, 1967-----	45
Tuesday, November 14, 1967-----	61
Wednesday, November 15, 1967-----	75
Statement of—	
Bronson, Dorrance C., member, Board of Actuaries, Civil Service Retirement System, accompanied by Maurice Brown, Chief Actuary, Civil Service Commission-----	45
Hughes, Hon. Phillip S., Deputy Director, Bureau of the Budget, accompanied by David McAfee, management analyst, Bureau of the Budget-----	61
Staats, Hon. Elmer B., Comptroller General of the United States, accompanied by Gregory J. Ahart, Deputy Director, Civil Division; Frederick H. Smith, Deputy Director, Office of Policy and Special Studies; and John C. Fenton, Assistant Director, Civil Division, General Accounting Office-----	95
Macy, Hon. John W., Jr., Chairman, Civil Service Commission, accompanied by Andrew E. Ruddock, Director, Bureau of Retirement and Insurance, Civil Service Commission-----	23
Additional material:	
H.R. 10912, incorporating the administration's legislative proposal--	2
Letter dated June 8, 1967, from Hon. John W. Macy, Jr., to Hon. John W. McCormack, transmitting administration's proposal--	4
Sectional analysis of administration's proposal-----	7
Attachment showing past retirement system policies and practices--	9
Illustrations regarding retirement funding and financing-----	12-22
Report by the Comptroller General of the United States re "Financing the civil service retirement system administered by the Civil Service Commission," issued to the Congress of the United States in April 1967-----	75

RETIREMENT FINANCING

WEDNESDAY, NOVEMBER 8, 1967

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON RETIREMENT, INSURANCE, AND HEALTH BENEFITS OF THE COMMITTEE ON POST OFFICE AND CIVIL SERVICE,

Washington, D.C.

The subcommittee met at 10:45 a.m., in room 210, Cannon House Office Building, Hon. Dominick V. Daniels (chairman of the subcommittee) presiding.

Mr. DANIELS. The Subcommittee on Retirement, Insurance, and Health Benefits will come to order.

Mr. Commissioner, I wish to express the Chair's regrets on getting started late this morning, but I would like to explain to you that other members of the subcommittee are tied up at other committee hearings.

Important legislation is pending before some of these committees and their presence was requested by the chairman.

In addition thereto, I understand there is a Republican caucus which unexpectedly took place at 9:30 this morning, and all Republicans, I assume, are attending this caucus. So, on behalf of myself and other members of the subcommittee, I wish to express my regrets in not getting started earlier.

The Subcommittee on Retirement, Insurance, and Health Benefits is meeting this morning to begin an extensive review of the past and present practices of funding the civil service retirement system, with the view toward development of a program of action to strengthen its financial condition.

The system, since its inception in 1920, has required mandatory employee contributions approximating one-half the normal cost of benefits to which they and their survivors become entitled. While various methods have been used during this 47-year period to determine appropriations to meet the employer's share of costs, the Government has never required automatic appropriation of amounts to support its liability to the program.

The program is a vital part of the Federal employment system, and one of paramount importance to the Government's millions of retired, active, and potential civilian employees and their families. It will be our purpose, in conducting these hearings, to attempt to recognize the problems resulting from past and present financing practices, and to resolve any doubts as to the system's ability to fulfill its obligation.

Without objection, the bill, H.R. 10912, incorporating the administration's legislative proposal which the Chair introduced upon request, the letter from the Chairman of the Civil Service Commission transmitting such proposal to the Speaker of the House, and accompanying material, will be inserted in the record at this point.

(The documents follow:)

[H.R. 10912, 90th Cong., first sess.]

A BILL To amend subchapter III of chapter 83 of title 5, United States Code, relating to civil service retirement

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 8331 of title 5, United States Code, is amended—

- (1) by striking out “and” at the end of paragraph (15);
- (2) by striking out the period at the end of paragraph (16) and inserting a semicolon in place thereof; and

(3) by adding the following new paragraphs after paragraph (16):

“(17) ‘Normal cost’ means the entry-age normal cost computed by the Civil Service Commission in accordance with generally accepted actuarial practice and expressed as a level per centum of aggregate basic pay.

“(18) ‘Fund balance’ means the sum of (A) the investments of the fund calculated at par value, and (B) the cash balance of the fund on the books of the Treasury.

“(19) ‘Unfunded liability’ means the estimated excess of the present value of all benefits payable from the fund to present and former employees and members subject to this subchapter and to their survivors over the sum of—

“(A) the present value of deductions to be withheld from the future basic pay of employees and Members currently subject to this subchapter and of future agency contributions to be made in their behalf; plus

“(B) the present value of Government payments to the fund under section 8348(f) and (g) of this title; plus

“(C) the fund balance as of the date the unfunded liability is determined; and

“(20) ‘employee equity’ means the estimated total of lump-sum credits and voluntary contribution accounts of present and former employees and Members, less the estimated total of annuity payments made to them and chargeable to the credits and accounts.”

SEC. 2. Section 8334 of title 5, United States Code, is amended—

- (1) by amending subsection (a) to read:

“(a) (1) The employing agency shall deduct and withhold $6\frac{1}{2}$ per centum of the basic pay of an employee and $7\frac{1}{2}$ per centum of the basic pay of a Member. An equal amount shall be contributed from the appropriation or fund used to pay the employee or, in the case of an elected official, from an appropriation or fund available for payment of other salaries of the same office or establishment. When an employee in the legislative branch is paid by the Clerk of the House of Representatives, the Clerk may pay from the contingent fund of the House the contribution that otherwise would be contributed from the appropriation or fund used to pay the employee.

“(2) The percentage of deductions and contributions prescribed by paragraph (1) of this subsection shall be adjusted by the Civil Service Commission as necessary to meet fully the normal cost of the benefits then in effect. Any such adjustment shall become effective with the first full pay period in the calendar year beginning after the date of publication in the Federal Register. The same percentage adjustment shall be applied to each percentage prescribed by paragraph (1) of this subsection and shall be fixed at the nearest multiple of one-fourth of 1 per centum.

“(3) The amounts so deducted and withheld, together with the amounts so contributed, shall be deposited in the Treasury of the United States to the credit of the fund under such procedures as the Comptroller General of the United States may prescribe. Deposits made by an employee or Member also shall be credited to the fund.”

(2) by inserting in subsection (c), immediately before the colon, the following: “, plus each increase in the deduction percentage prescribed under subsection (a) (2) of this section for periods of service to which the increase applies.”

SEC. 3. Section 8348 of title 5, United States Code, is amended—

- (1) by amending subsection (a) to read:

“(a) There is a Civil Service Retirement and Disability Fund. The fund is appropriated for the payment of—

“(1) benefits as provided by this subchapter; and

“(2) administrative expenses incurred by the Civil Service Commission in placing in effect each annuity adjustment granted under section 8340 of this title; and

"(3) under such procedures as the Chairman of the Civil Service Commission may approve, benefits provided for Foreign Service beneficiaries that were formerly payable from the Foreign Service retirement and disability fund; and is made available, subject to such annual limitation as the Congress may prescribe, for any expenses incurred by the Civil Service Commission in connection with administration of this or other retirement and annuity statutes."

(2) by striking out subsections (f) and (g) and inserting in place thereof:

"(f) Any statute that authorizes—

"(1) new or liberalized benefits;

"(2) extension of coverage to new groups of employees;

"(3) annuity increases, other than adjustments under section 8340 of this title; or

"(4) increases in pay on which benefits are computed;

shall authorize appropriations to the fund to finance the unfunded liability created by that statute, beginning on the date the statute becomes effective and continuing over a thirty-year period, in accordance with the following schedule:

"THIRTY INSTALLMENTS, INCREASING-PAYMENT AMORTIZATION SCHEDULE FOR EACH \$1,000,000 INCREMENT OF UNFUNDED LIABILITY AT 3½ PER CENTUM INTEREST, FIRST PAYMENT DUE ON EFFECTIVE DATE OF LEGISLATION CREATING UNFUNDED LIABILITY

"Year:	Annual payment
1	\$4,051
2	8,102
3	12,153
4	16,205
5	20,256
6	24,307
7	28,358
8	32,409
9	36,460
10	40,511
11	44,562
12	48,613
13	52,665
14	56,716
15	60,767
16	64,818
17	68,869
18	72,920
19	76,971
20	81,023
21	85,074
22	89,125
23	93,176
24	97,227
25	101,278
26	105,329
27	109,380
28	113,431
29	117,483
30	121,534

"(g) In any fiscal year in which the Civil Service Commission estimates that the fund balance at the end of the year will be less than the employee equity at that date, or that the fund balance at the end of the year will be less than at the end of the preceding fiscal year, the Commission shall—

"(1) notify the Secretary of the Treasury, and the Secretary, before closing the accounts for the year, shall credit to the fund, as a Government contribution, out of any moneys in the Treasury not otherwise appropriated, such sum as may be necessary to make the fund balance at the end of the fiscal year equal to the employee equity at that date or to the fund balance at the end of the preceding fiscal year, whichever is the greater; and

"(2) report to the President and to Congress any sums credited to the fund under this subsection.

"(h) For the purpose of this section, and in estimating the unfunded liability and the employee equity, the Commission may take into consideration the effect on the fund of benefits provided for Foreign Service beneficiaries that were formerly payable from the Foreign Service Retirement and Disability Fund."

SEC. 4. The proviso under the heading "PAYMENT TO CIVIL SERVICE RETIREMENT AND DISABILITY FUND" in section 101, title I of the Act of August 17, 1961 (Public Law 87-141; 75 Stat. 345), is repealed.

SEC. 5. (a) The Secretary of the Treasury shall transfer the gross assets of the Foreign Service Retirement and Disability Fund to the Civil Service Retirement and Disability Fund. All moneys thereafter deducted, contributed, or deposited by or on behalf of participants in the Foreign Service Retirement and Disability System shall be deposited in the Treasury of the United States to the credit of the Civil Service Retirement and Disability Fund.

(b) The Secretary of State shall continue to administer the Foreign Service Retirement and Disability System as provided by section 801 of the Foreign Service Act of 1946, 60 Stat. 1019 (22 U.S.C. 1061), and shall report annually to the President on the operations of the system. The Chairman of the Civil Service Commission shall from time to time review policies and procedures followed in the administration of the system and shall advise the Secretary on any changes he believes desirable or necessary.

SEC. 6. This Act, except sections 2, 3, and 5, shall become effective on enactment. Sections 2, 3, and 5 shall become effective on January 1 of the year following enactment.

LETTER OF TRANSMITTAL

U.S. CIVIL SERVICE COMMISSION,
Washington, D.C., June 8, 1967.

HON. JOHN W. MCCORMACK,
Speaker of the House of Representatives.

DEAR MR. SPEAKER: I submit for the consideration of Congress, and urge early action on, a proposal to improve financing and funding of the civil service retirement system.

By the end of this fiscal year, the unfunded liability of the system will top \$48 billion. Under present financing practices, the unfunded liability will continue to grow by more than \$1.5 billion every year, sometimes much more; disbursements will outstrip receipts by 1974; and by 1987 the present (January 31) \$17.1 billion balance will be reduced to nothing. The year-by-year effect of continuing current financing policy is shown in table 1 attached.

This situation did not develop overnight. It is the product of years of inadequate financing. Employees have always paid their full share of retirement costs as set by law. Government has appropriated substantial sums to the civil service retirement and disability fund from time to time, but it has not contributed, regularly and systematically, in amounts sufficient to meet that portion of accruing costs not covered by employee contributions. (Attachment A summarizes past financing action.) The fund has lost the interest that would otherwise have been earned on investment of the additional contributions, a loss that now amounts to \$1.7 billion a year. Successive benefits liberalizations, inadequately financed, have compounded the problem. In its report on valuation of the fund as of June 30, 1965, the Board of Actuaries of the civil service retirement system points out that "before this report is made, the total fund will have fallen even below the liabilities for existing annuitants and separated employees. This means, in effect, that no funds would exist in respect of nonretired persons, either as to their accrued annuities or as to their own accumulated contributions."

The Civil Service Commission strongly urges adoption of a definite program of action to meet this growing financial threat. We recommend a three-step approach, the first to cover normal costs of the system, the second to cover increases in the unfunded liability resulting from legislation enacted in the future, and the third to discharge Government's responsibility for the unfunded liability created by legislation already enacted. The proposal provides that—

1. Full normal costs of present benefits and of all liberalizations authorized in the future be paid into the fund currently via matching agency and employee contributions. Contribution rates would be raised, equally for employees and agencies, whenever liberalized eligibility requirements or benefits increase normal costs.

2. All future substantive and pay raise legislation which would otherwise increase the unfunded liability specifically authorize payments to the fund in accordance with a 30-year schedule written into the retirement law. These payments would begin at a nominal rate the first year; increase in regular amounts, by arithmetic progression, each year thereafter; and cover within a 30-year period the entire cost, including interest, of the unfunded liability created by the legislation. In every case the authorization would be accompanied by an immediate appropriation in the amount called for by the schedule for the first year.

3. Permanent, indefinite appropriations be authorized to "peg" the fund at the highest yearend balance it reaches or at employee equity, whichever is greater. Pegging would be accomplished via automatic transfers of moneys from the general revenues of the Government to the trust fund as needed to maintain the latter at the designated level of adequacy. Moneys so transferred would pay underfinanced benefits earned during service already performed and granted by legislation already enacted, but due to be paid in the future.

The recommended approach is one of several different methods which might be adopted. The Board of Actuaries, for example, has repeatedly recommended that Government make direct appropriations equal to the amount necessary, in addition to the contributions of employees and employing agencies, to meet the full normal cost and the amount of accruing interest on the deficiency. The Committee on Retirement Policy for Federal Personnel, created by Congress in 1952 to study all Federal retirement systems, made a similar recommendation, tempered by a recognition that the fiscal situation of the Government might make necessary a gradual rather than immediate approach to that goal. A 1963 administration proposal recommended full funding of all future benefits increases, continuation of matching employee and agency contributions, and supplemental agency contributions gradually increasing to the level at which normal cost plus interest funding would have been attained. Though hearings were held on that proposal (S. 1562), legislation was not enacted by the 88th Congress and, pending completion of a study by the Cabinet Committee on Federal Staff Retirement Systems, no financing recommendation was submitted to the 89th Congress.

The current proposal is the one recommended to the President by the Cabinet Committee and endorsed by him in his March 7, 1966, pay message. If adopted, it would—

Require advance provision to meet full estimated costs of retirement, including costs of present benefits, costs of benefits already earned but due to be paid in the future, and costs of benefits resulting from future legislation including general pay increases.

Ease the impact of these costs on the administrative budget for several years into the future.

Increase contribution rates of employees and agencies in January of 1968, and thereafter as required by future liberalizations, to cover normal cost of the benefits in effect. (Normal cost of present benefits is 13.86 percent, nearly 1 percent above current contribution rates; the rate increase will be one-half of 1 percent even if there are no benefit liberalizations.)

Provide a measure of "braking" effect on pressures for undue liberalizations.

Control, and eventually stop, growth of the unfunded liability.

Keep fund receipts ahead of disbursements, and prevent depletion of the fund (otherwise expected to occur in 1987).

Prevent excessive buildup of the fund in advance of actual need for the money.

Assure payment of earned benefits, in full and on time, without awaiting appropriation action to provide funds for benefits already due.

Table 2 shows estimated progress of the fund under this financing method, assuming present benefit and pay levels.

Draft legislation which would amend the retirement law in accordance with this recommendation is attached, together with a sectional analysis. The draft legislation would also—

Make the fund available for payment of the Commission's expenses in connection with administration of retirement laws. Such expenses are now being paid from the fund under appropriation authority enacted last year (Public Law 89-128), but substantive legislation is needed and the House Appropriations Committee urges that we seek it promptly.

Merge into one the civil service and the Foreign Service retirement and disability funds (but not the benefit structure or the administration of the two systems). Both funds are experiencing the same difficulties, for the same reasons. The Foreign Service retirement and disability system is so small in comparison with that for the civil service system that merging funds could have no significant actuarial effect on financing of the larger system.

Repeal certain estimating and other requirements which will no longer be necessary if the proposed financing method is adopted.

The Civil Service Commission believes that administration of the retirement system is one of its most important responsibilities. It is an essential part of a modern employment system designed to attract and retain employees of the caliber required to conduct the complex business of Government. It contributes importantly toward financial security for millions of past, present, and future Government employees and their dependents. There should never exist the slightest doubt

of the system's ability to meet its commitments to these people. That doubt now exists.

The Government's financial obligation is clear. The Government's recognition of, and action to meet, that obligation is imperative. The situation has been studied intensively during the past few years by the Civil Service Commission, the Bureau of the Budget, the Cabinet Committee on Federal staff retirement systems, and the Board of Actuaries and has been discussed extensively with congressional committees. It is time, now, that Government face the problem realistically and adopt some definite program to meet it.

In our judgment, the recommended approach is sound and will accomplish the required results. Its impact on the administrative budget will be sudden and sharp, beginning around 1975, but that impact will nevertheless be far less drastic than if present financing practices continue unchanged. The longer action is delayed, the larger will be the problem to be dealt with. We strongly urge, therefore, prompt and positive action to solve the problem of retirement financing and funding in such a way as to maintain confidence in the integrity of the system and to assure that there is always enough money in the fund to permit payment of all benefits due, in full and on time.

The Bureau of the Budget advises that enactment of this proposal would be in accord with the President's program.

By direction of the Commission:

Sincerely yours,

JOHN W. MACY, Jr., *Chairman.*

SECTIONAL ANALYSIS

The proposed statutory changes involve sections 8331, 8334, and 8348 of subchapter III of chapter 83 of title 5, United States Code, respecting civil service retirement.

Section 1 amends section 8331 by adding paragraphs (17), (18), (19), and (20). Paragraph (17) defines "normal cost" as the level percentage of the basic pay of all new employees needed throughout their careers to finance the retirement benefits they will earn. Paragraph (18) defines "Fund balance", for purposes of financing, as the par value of securities in which retirement money is invested plus the uninvested cash remaining in the retirement fund. Paragraph (19) defines "unfunded liability" as the estimated amount needed to finance all benefits due present and former employees and Members from the fund, less money now in the fund and to be placed in it in the future. Paragraph (20) defines "employee equity" as the total of active employee contributions, contributions of employees separated with title to future annuity, and contributions of annuitants, less benefits already paid to them or in their behalf.

Section 2 amends the substance of section 8334(a) in two respects. It authorizes the Civil Service Commission to raise employee and Government contribution rates, in equal amounts, to cover fully the normal cost of retirement benefits, including benefits provided by legislation enacted in the future, and it provides for carrying such increased deduction rates into the computation of deposits due for service for which deductions were not currently withheld. A rate increase of at least one-half of 1 percent would be required in January

of 1968. Additional rate increases would be effective the first pay period in the calendar year beginning after publication of the adjusted rate in the Federal Register.

Section 2 also divides section 8334(a) into numbered subparagraphs to improve organization and clarity of the section as revised.

Section 3 amends section 8348(a) by adding a provision making the fund available, subject to annual limitations set by Congress, for administrative expenses incurred by the Commission in connection with operation of the civil service and other retirement and annuity laws. Such expenses are now paid from the fund under authority of appropriation language, which should be replaced by substantive legislation.

Section 3 also amends section 8348(a) by appropriating the fund for payment under procedures established by the Chairman of the Civil Service Commission, of Foreign Service Retirement and Disability System benefits. This authority is needed because, under another provision of the bill, the Foreign Service fund (but not the system itself) would be merged with the civil service fund. The procedures to be established by the Chairman of the Commission would govern methods and arrangements for payment of Foreign Service beneficiaries but not determination of eligibility for Foreign Service retirement benefits or timing of payments relating to selection-out, which decisions would continue to be made in accordance with provisions of the Foreign Service Act of 1946, as amended, and regulations relating thereto.

Section 3 further amends section 8348 by striking out present subsections (f) and (g) and adding new subsections (f), (g), and (h).

New subsection (f) requires appropriations to the fund, in accordance with a 30-year annual installment table incorporated therein, to finance fully all additional increases in the unfunded liability created by future liberalizing legislation, including pay raises and extension of coverage to new groups of employees. The required annual appropriation in each instance begins at a nominal rate the first year, increases by arithmetical progression each year thereafter, and covers in the 30-year period the total cost of the unfunded liability created by the legislation involved.

New subsection (g) requires the Secretary of the Treasury to effect a Government contribution from the general revenues to the fund at the end of each fiscal year in which the Civil Service Commission estimates that the fund balance at the end of that year will be less than either the prior year's fund balance or employee equity. In this fashion, the United States would discharge its responsibility for the unfunded liability created by legislation enacted prior to the effective date of these amendments, including the cost-of-living adjustments authorized by section 8340. The Commission would report to Congress and the President the amounts so transferred by the Secretary of the Treasury.

New subsection (h) provides that in making the estimates and reports which affect financing and funding activities, the Commission may take into account the income and the liabilities (present and future) of the Foreign Service retirement and disability system, beneficiaries of which would be paid from the merged fund.

The deleted subsection (f) requires the Commission to submit estimates of appropriations needed to finance the fund on a normal cost-plus-interest basis, and the deleted subsection (g) bars (with certain exceptions) use of the fund to pay increased benefits until such time as appropriations sufficient to cover any immediately resulting increase in the unfunded liability are made. These provisions will no longer be meaningful or necessary if the financing method proposed in these amendments, especially section 8334(a)(2) and the new subsections 8348 (f) and (g), are adopted.

Section 4 would repeal the requirement in Public Law 87-141 (75 Stat. 345) that the Commission submit annual estimates of the appropriations necessary to reimburse the fund for the cost of annuity increases voted in 1958 but not fully covered by appropriations. This provision will be unnecessary if the proposed financing method is adopted.

Section 5(a) directs the Secretary of the Treasury to transfer the assets of Foreign Service retirement and disability fund to the civil service retirement and disability fund, which is thereafter to be credited with all deductions, contributions, and deposits in behalf of participants in Foreign Service system. *Section 5(b)* provides that the Secretary of State shall continue to administer the Foreign Service retirement and disability system, and shall report annually to the President on the operation of that system. The Chairman of the Commission is directed to review the policies and procedures followed in the administration of the Foreign Service system and to advise the Secretary of State when he believes changes are desirable. The effect would be that the civil service and the Foreign Service funds, but not the benefit structure or the administration of the two systems, would be merged into one, and the Foreign Service retirement and disability fund would thereafter lose its separate identity.

Section 6 provides that the proposed amendments become effective upon enactment, except sections 2, 3, and 5 which would become effective on the January 1 following enactment.

ATTACHMENT A—PAST RETIREMENT SYSTEM POLICIES AND PRACTICES

Employees have contributed to the system since it started operation in 1920. During this period of more than 45 years a number of methods for determining appropriations to meet the Government's share of costs have been used, and the attitude of the Congress and its committees toward these approaches has changed from time to time.

In the first 8 years of the system's existence (1920-28) no appropriations were recommended by the President or enacted by the Congress.

From 1929 to the World War II period, appropriations were generally recommended by the President on a basis to cover normal cost and to amortize the unfunded liability by the end of this century. From 1929 through 1949 the appropriations enacted by the Congress were those recommended by the President.

In the 8-year period 1950 to 1957, appropriations based on several different methods were recommended by the President. The Congress enacted lower appropriations on five occasions, higher amounts twice, and on one occasion approved the amount proposed. The budget

recommendation for the fiscal year 1953 was based on normal cost plus amortization over a 30-year period and was reduced somewhat by the Congress. Recommendations for appropriations to cover normal cost plus interest for each of the years 1950, 1951, 1952, and 1954 were reduced by the Congress. A recommendation for 1955 to cover only the additional cost of annuities increased by a then-recent enactment was approved by the Congress. On the other hand, requested appropriations for 1956 and 1957, computed on the basis of the Government's share of costs for current disbursements less the interest on its equity in the fund, were increased.

The present method of financing was recommended by the Civil Service Commission and enacted by the Congress in the Civil Service Retirement Act Amendments of 1956 (Public Law 84-854), effective at the beginning of fiscal year 1958. Under it, each employing agency contributes to the fund, from its appropriations for payment of salaries, amounts equal to deductions from the salaries of its covered employees at the rate of 6½ percent, or 7½ percent for Members of Congress. Adoption of the agency contribution provision achieved the desirable objective of assuring annual income approximating normal cost.

However, agency matching contributions are not sufficient to meet fully the Government portion of retirement cost, because no significant provision is now being made toward the unfunded liability or even toward the interest on it. In recognition of this fact, Congress provided in section 17(e) of the 1956 amendments (now section 8348(f) of title 5, U.S.C.), that the Commission submit estimates of the appropriations necessary to finance the fund on a normal cost-plus-interest basis. It did not, however, require automatic appropriation of amounts so estimated, leaving final determination of amounts to be recommended for this purpose to the discretion of the President. Accordingly, the Commission's estimates have been forwarded to the Bureau of the Budget for consideration as part of the normal process of formulating the executive budget. The President's final determination has been made only after consideration of the financial status of the system, including its unfunded liability, in the light of the general fiscal situation of the Government. This procedure is in keeping with the tradition of executive development of the budget.

The President did not request an appropriation to the retirement fund in his budget for the fiscal years 1959 or 1960, beyond the amounts to be appropriated to the various agencies. For fiscal year 1959, Congress voted an appropriation to the fund of \$589 million more than the agencies' contributions included in the President's budget. This amount plus employee and agency contributions equaled full normal cost plus interest. The President vetoed this bill, and Congress accepted his view.

For fiscal years 1961 and 1962, appropriations were made to the fund for the specific purpose of continuing in effect, certain annuity increases and new survivor benefits provided by Public Law 85-465; for fiscal year 1963 and each year thereafter, appropriations have been requested and made to cover the benefits provided by Public Law 87-793. Otherwise, no appropriations beyond the matching agency contributions have been made.

The following table summarizes requests for and appropriations to the fund since 1950:

Comparative table—Budget requests and appropriations

Fiscal year	Budget request to Congress	Appropriated by Congress
1950.....	\$328,292,000	\$301,290,728
1951.....	333,344,000	305,000,000
1952.....	320,450,350	310,000,000
1953.....	457,869,000	321,450,000
1954.....	¹ 427,141,000	² 31,397,000
1955.....	² 29,623,000	² 29,623,000
1956.....	0	233,000,000
1957.....	295,000,000	525,000,000
1958.....	0	0
1959.....	0	0
1960.....	0	0
1961.....	³ 46,329,000	46,329,000
1962.....	³ 44,637,000	⁴ 44,637,000
1963.....	³ 30,000,000	⁵ 30,000,000
1964.....	³ 62,000,000	⁶ 62,000,000
1965.....	³ 65,000,000	⁵ 65,000,000
1966.....	³ 67,000,000	⁵ 67,000,000
1967.....	³ 73,000,000	⁵ 73,000,000
1968.....	³ 71,000,000	-----

¹ Of this amount, \$176,139,000 was for "normal cost"; \$192,015,000 for "interest"; and \$58,987,000 for "increases in annuities."

² For increases in annuities.

³ For continuation of increases in annuities and new survivor annuities under Public Law 85-465.

⁴ Need for this amount was removed by Public Law 87-114 and the President's budget for fiscal year 1963 reflected an item proposed for later transmission to rescind this appropriation. Congress, however, made the appropriation without regard to Public Law 87-114.

⁵ To pay increased benefits provided by Public Law 87-793.

⁶ To pay increased benefits provided by Public Law 87-793. The President's budget for fiscal year 1964 reflected an item proposed for later transmission providing for permanent financing of the retirement fund and rescinding this appropriation. Congress, however, made the appropriation.

Retirement Funding and Financing

USC9C
ERI
1-20-67

Purposes —

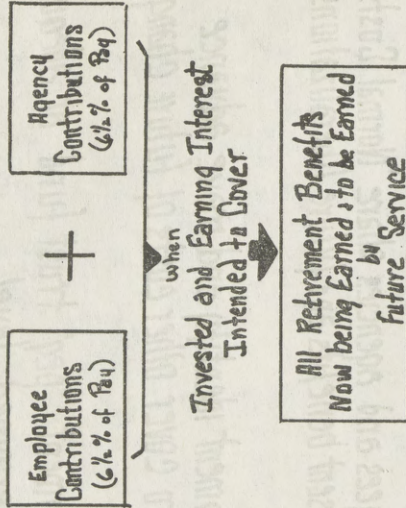
- Full recognition of retirement costs
- Orderly advance preparation to meet them
- Control of "Unfunded Liability"
- Fund balance sufficient to assure prompt, full benefit payments

Proposal in Brief —

1. Employees and agencies share "Normal Costs" of present benefits and future liberalizations
2. Government identify and make advance plans to cover other costs of future changes
3. Government "peg" trust fund at adequate predetermined level

Where We Are

- Fund Balance \$ 16.8 billion
- Annual Receipts \$ 2.8 billion
 - \$1.1 billion from agencies
 - \$1.1 billion from employees
 - \$0.6 billion from interest
- Annual Disbursements \$ 1.9 billion

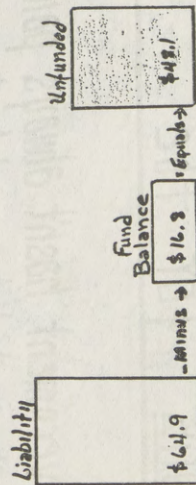


This is "NORMAL COST" Financing
Now 13.96%

Normal Cost Only Part of Story:

Liabilities Exceed Assets by \$48.1 billion

This is the "Unfunded Liability"



The Unfunded Liability

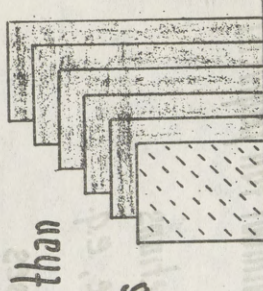
GROWS more than

1 1/2 billion dollars

each year —

sometimes more

why??

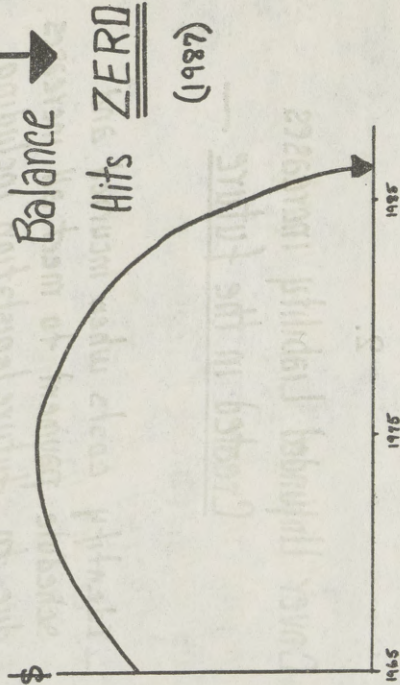
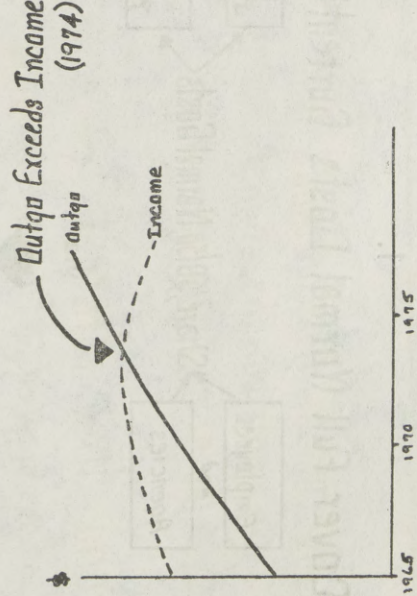


Reasons for the Unfunded Liability

1. Government hasn't always paid
 - No contributions at first
 - 50/50 sharing only since 1957
2. Fund lost interest
 - Loss now at \$1.7 billion annually
3. New or liberalized benefits without full payment
 - Annuity increases
 - Low "early retirement" reductions
 - Underfunded past service, e.g.
 - "Free" credit
 - 1956 Amendment increases
 - Pay raises →

Every \$1 general pay increase
adds \$2.50 to Unfunded Liability

Under Present Financing

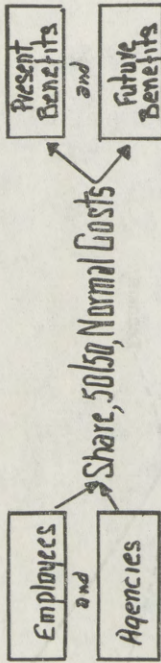


We Must Plan to Meet This Problem

How to Do It

1.

Cover Full Normal Costs Currently



via



MATCHING CONTRIBUTIONS

— raised when benefits raised

2.

Cover Unfunded Liability increases

Created in the future —

— Identify costs when incurred and schedule payment to meet all increases due to future legislation, including

- pay increases for actives
- liberalizations
- newly authorized annuity increases
- coverage of new groups



Do This via

Authorization in law, when cost is incurred,
of a 30-Year schedule of payments, to

- begin at nominal rate 1st year
- increase in regular amounts each succeeding year
- cover entire cost in 30 years

30-Year Amortization Schedule

for each \$1 Million Increase in Unfunded Liability
@ 3½ % Interest

Year	Annual payment	Year	Annual payment
1	\$ 4,031 *	17	\$ 68,869
2	8,102	18	72,920
3	12,153	19	76,971
4	16,205	20	81,023
5	20,256	21	85,074
6	24,307	22	89,125
7	28,358	23	93,176
8	32,409	24	97,227
9	36,460	25	101,278
10	40,511	26	105,329
11	44,562	27	109,380
12	48,613	28	113,431
13	52,665	29	117,483
14	56,716	30	121,534
15	60,767		
16	64,818		
			Total payments \$1,883,774

* 1st installment due upon enactment of legislation
creating the increased liability

How to Do It

3. Government cover liability
created by laws already passed
 - present unfunded liability
 - cost-of-living increases

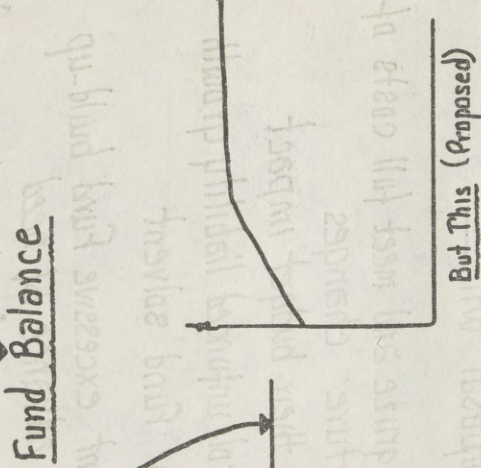
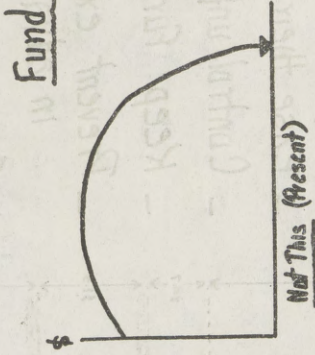
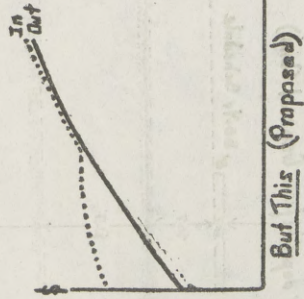
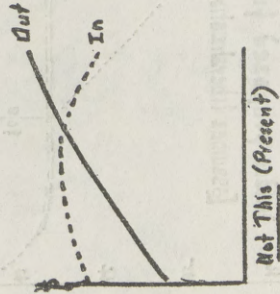
via

Permanent Indefinite Authority

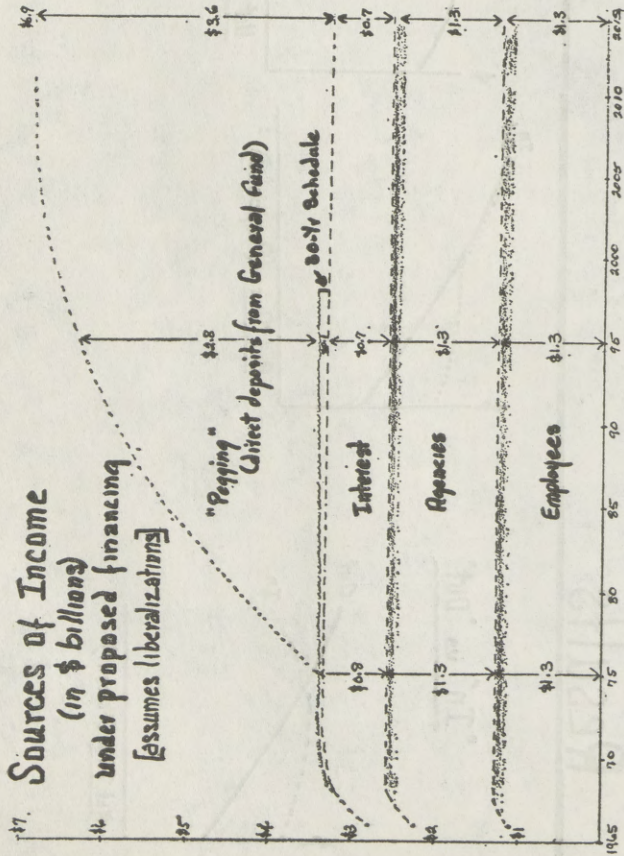
that will "peg" fund at its peak
or at "employee equity", whichever
is greater

Results

"In" vs "Out"



Sources of Income (in \$ billions) under proposed financing [assumes liberalizations]



This Proposal Will —

- Recognize and meet full costs of future changes
- Ease their budget impact
- Control unfunded liability growth
- Keep Fund solvent
- Prevent excessive Fund build-up in advance of need
- Assure prompt, full benefit payment

Mr. DANIELS. The subcommittee is pleased to welcome, as the initial witnesses, the Chairman of the U.S. Civil Service Commission, the Honorable John W. Macy, Jr., and his able aide, the Director of the Commission's Bureau of Retirement and Insurance, Mr. Andrew E. Ruddock.

STATEMENT BY HON. JOHN W. MACY, JR., CHAIRMAN, U.S. CIVIL SERVICE COMMISSION, ACCOMPANIED BY ANDREW E. RUDDOCK, DIRECTOR, BUREAU OF RETIREMENT AND INSURANCE, U.S. CIVIL SERVICE COMMISSION

Mr. MACY. Mr. Chairman, thank you very much.

I appreciate the opportunity to appear before your committee in support of your bill, the bill you introduced upon request, H.R. 10912, which would amend the civil service retirement law to improve financing and funding of the system. Your action in introducing this bill, in publishing the Commission's proposal—Committee Print No. 2—and in calling these hearings will assist greatly in gaining a broader understanding of the difficult problems faced in the long-term financing of the Government's admirable retirement system.

As you have already indicated, Mr. Chairman, you have inserted in the record Committee Print No. 2. I believe this is an important part of the record.

The proposed financing method is new in concept and new in mechanics. It was recommended to the President by his Cabinet Committee on Federal Staff Retirement Systems and was endorsed by him in his March 7, 1966, message to the Congress on pay and fringe benefits. It has his full support and backing.

The purposes of the proposal are outlined on the inside cover of the explanatory booklet you have before you. While my oral explanation will be complete, you may find it somewhat clearer if you follow along with the booklet. The purposes of the proposal are to—

Identify and recognize the full costs of retirement benefits;

Make orderly advance preparation to meet those costs;

Control growth of the "unfunded liability"; and

Keep a fund balance on hand high enough to assure prompt payment of all benefits as they become due in the future.

Very briefly, the proposal is that—

1. Employees and their agencies share equally, via matching contributions, the "normal cost" of present benefits and of all future liberalizations authorized by Congress.

2. Government identify, acknowledge its responsibility for, and make advance provisions to meet, other costs of future changes.

3. Government acknowledge its responsibility for costs already incurred, and meet that responsibility by "pegging" the retirement fund at an adequate predetermined level.

Let me start with where we are, summarized on page 2. As of October 1966, we had a civil service retirement fund balance of \$16.8 billion, most of it invested in interest-bearing securities of the United States. Annual receipts totaled \$2.8 billion, of which \$1.1 billion came from agencies, another \$1.1 billion from employees, and more than half a billion from interest on investments. Annual benefit payments were running \$1.9 billion a year. As of June 30, 1967, the balance had risen

to \$17.7 billion, receipts from matching contributions to \$2.4 billion, receipts from interest to \$625 million, and benefit payments to \$2 billion. For the sake of simplicity, however, the figures I will be citing throughout this testimony will be those that applied at the time the proposal was submitted to Congress earlier this year.

From page 3 you see that employee contributions are now at 6½ percent of pay, and that agency contributions of 6½ percent match them. These combined contributions, when invested and earning interest, cover most of the cost of the retirement benefits now being earned and to be earned in the future, so long as benefits are not increased. If current contributions fully covered benefits currently being earned, we would have "normal cost" financing.

Normal cost is that level percentage of annual pay which, invested at interest, is required to cover the cost of benefits earned each year, starting, of course, for each employee at the time he is appointed.

Normal cost of the present system is now estimated at 13.86 percent of payroll—almost 1 percent higher than the current contribution rate.

As you can see from page 4, normal cost is only part of the story, and the financial future of the system is not bright.

Mr. DANIELS. At that point, Commissioner, if we were to meet normal costs, it would be necessary, therefore, for the employee as well as the Government to contribute an additional one-half percent a year.

Mr. MACY. That's right. If we were to cover normal costs on an equal sharing basis at the level of present benefits, it would be necessary to increase the contributions for each by one-half percent, or to 7 percent. The 7 percent would give us slightly above the present normal costs.

We have a liability, over and above our assets, estimated at something more than \$48 billion as of June 30, 1967. This is a liability already incurred, but due to be paid in the future, for benefits based on services employees have already performed for Government. The present fund, together with normal cost financing for the present and the future, will not cover payment of these benefits. The difference between the assets and the liability is the "unfunded liability."

Already topping \$48 billion, the unfunded liability normally grows by more than \$1½ billion every year. Sometimes it grows much more, as in 1966, and again in 1967, when it increased about \$4 billion per year.

Mr. DANIELS. How did that come about?

Mr. MACY. This was due to salary increases and liberalization of benefits. As I will explain, there are three major reasons for the unfunded liability. Those are outlined on pages 6 and 7 of the pamphlet. These reasons are why we have this unfunded liability, and why it increases each year, or why, in other words, we face this financial threat at the present time and for the future.

No. 1, Government has not always made timely payment of its full share of the cost.

From the very beginning, the law has specified the rate of contribution to be made by employees, and employees have contributed at that rate. The Government has been responsible for that part of the total

cost not met by employee contributions. Throughout the first 8 years of the system's operation, all benefits were paid from current contributions of employees; Government made no contributions at all, though it did pay costs of administering the system.

Government has appropriated substantial amounts to the fund from time to time, but it has not contributed its share of estimated cost in a regular and systematic way as employees have done. It is only since 1957, for instance, that agencies have been required to match employee contributions.

No. 2, the fund has lost in past years, and still continues to lose, interest it would have earned if all payments had been made on time, in full, and invested at interest. The size of this loss is significant, and increasingly; it now runs \$1.7 billion per year.

No. 3, perhaps most serious of all, new or increased benefits have been granted many times without arranging to place in the fund the full amount of money those new or increased benefits actually cost. For example:

Major annuity increases have been given to already retired employees on numerous occasions, but the retired employees, quite properly, made no contributions toward the cost of those increases. To cite a fairly recent example, the December 1965 annuity increase legislation raised, by an average of 7.3 percent, the annuities of persons already retired, and no additional money was provided to cover the actual cost of those increases. The point that needs to be made here is that all such increases, regardless of how desirable they may be, add to the unfunded liability of the system unless adequate provision is made for supplemental financing.

"Early retirement" liberalizations are another example. The benefit reduction that is required for each year an employee is under age 60 at the time he retires optionally has been lowered from about 1½ percent a year to 3 percent, then to 1 percent, and finally last year, to 0 percent for those aged 55 or more—even though 6½ percent a year is about what such early retirement actually costs on a true actuarial basis.

Credit has been given for past service during which no contributions, or inadequate contributions, were made.

As a matter of fact, the system started with an unfunded liability, because when the act first became effective in 1920 all employees covered by it were given "free credit" for all service performed prior to that time, though of course neither they nor Government had contributed anything to a retirement fund during those years. We still pay annuities to several men and women who retired in 1921—they contributed only a few months but for more than 45 years have received benefits based on at least 15 years of prior service. Though most of these people are now gone, their underfinanced benefits were "borrowed" from the fund, and the debt still remains unpaid.

Another example: The 1956 amendments to the Retirement Act increased by about 25 percent the annuities persons then employed would receive on the basis of service they had already performed but for which they had contributed at a rate calculated to finance much lower annuities; no provisions were made, however, to cover that part

of the increased cost that was due to service already performed. More recently, Public Law 89-205 of 1965 increased by 6.1 percent the annuities of employees who chose to retire before the end of December 1965. Neither they nor Government had been contributing at a rate designed to support that level of benefit, and no supplementary financing was provided to cover this unanticipated extra cost; as a result, the unfunded liability rose by an estimated \$1 billion.

Still another example, and an important one: Every statutory pay raise—in contrast with normal career progression, which is already taken into account in estimating normal cost—automatically increases the unfunded liability. It does this because the formula for computing annuities produces what is, in effect, a percentage of final pay, or, more exactly, a percentage of the highest 5-year average, which is usually the final 5. If statutory pay increases raise the final pay, therefore, the employee gets the same benefit as if he had been earning at that higher rate through all his prior years of service, even though contributions were not made at that rate during all those years.

The effect, as far as retirement is concerned, is that a statutory pay raise is both prospective and retroactive for benefit purposes, but is prospective only for financing purposes. This effect is very significant. The 1966 statutory pay raises, for instance, increased the unfunded liability by \$880 million. We estimate that every \$1 of annual increase in salaries now adds \$2.50 to the unfunded liability of the retirement system. At this rate, the 1967 pay raise alone, if held to the level recommended by the President, will increase the unfunded liability by more than \$1.6 billion.

Mr. DANIELS. Well, the President recommended an across-the-board, 4½ percent, increase in salaries. Under the bill passed by the House, postal employees were granted a raise of 6 percent, so therefore, this unfunded liability—

Mr. MACY. It would be larger than this estimate by a factor of \$2.50 for every extra dollar. As I recall it, the increase by the postal employees increased the President's figure by \$58 million more, so this would raise the figure up to about a billion and three-quarters.

What all this adds up to is that every benefit added or liberalized has a price tag. When the benefit is based on service already performed and either not contributed for at all, or contributed for at a rate which did not fully cover its cost, the price is one that the system is not financed to meet. The unfunded liability goes up accordingly.

Now, I want to make it clear that we do not believe it either possible or desirable to stop the addition of the liberalizing of benefits. It is equally impossible and undesirable to make full prepayment of all new or liberalized benefits that might be authorized in the future—none of us has foresight good enough, nor a crystal ball clear enough, to tell us what these benefits might be or what they might ultimately cost.

Nevertheless, something must be done to meet a serious future problem. Pages 8 and 9 of the booklet show graphically what will happen if present financing practices continue unchanged.

Even assuming no further benefit changes, no further cost-of-living adjustments, no additional annuity increases, and no pay raises after

1966—an obviously unrealistic set of assumptions—the \$16.8 billion balance will hit zero in about 20 years.

We must plan in advance to meet this problem in an orderly and systematic way. We propose a three-step approach, the first to cover normal costs, the second to cover increases in the unfunded liability created by future legislation, and the third to discharge Government's responsibility for the unfunded liability created by legislation already on the books.

Step one of the proposal, outlined on page 10, is that full normal costs, both of present benefits and of all liberalizations authorized in the future, be paid currently.

Employees and agencies would share on a 50-50 basis, via matching contributions, the normal cost both of present benefits and of all future liberalizations.

This means that contribution rates would have to be raised on a 50-50 basis whenever eligibility requirements for retirement are liberalized or prospective benefits for active employees are increased.

Step two, page 11, proposes that Government identify, accept as its own responsibility, and make specific and timely provision to pay costs of all increases in the unfunded liability created by future legislation—at the time such legislation is enacted. This would include unfunded liability increases created by—

- (a) general pay raises for the active work force;
- (b) liberalizations that would give active employees higher benefits based on service performed before the increased benefit is authorized, and therefore contributed for at a below-cost rate;
- (c) newly authorized annuity increases for persons already on the rolls; and
- (d) coverage of any new groups brought into the system.

The mechanism we recommend for accomplishing this—page 12 of the booklet—would require that all future legislation which would otherwise increase the unfunded liability specifically authorize payments to the trust fund in accordance with a 30-year amortization table written into the proposed retirement legislation. These payments would—

- Begin at a nominal rate the first year;
- Increase in regular amounts, by arithmetic progression, each succeeding year; and

Cover within a 30-year period the entire cost, including interest, of the unfunded liability created by the substantive legislation.

In every case the authorization would be accompanied by an immediate appropriation in the amount called for by the schedule for the first year. In each subsequent year, the appropriation requests submitted to Congress would be sufficient to cover all amounts scheduled to be deposited in the trust fund in that particular year.

The recommended amortization schedule is shown on page 13 of the booklet and on page 6 of the bill. The amounts shown in the "annual payment" columns are the amounts that would be required to cover each \$1 million increase in the unfunded liability. They begin at \$4,051

per million for the first year and increase by that same amount per million each succeeding year until, in the 30th year, the final payment amounts to \$121,534 per million dollar increase in the unfunded liability.

These funds would be authorized, and appropriations would be scheduled in specific dollar amounts, at the time the additional liability was incurred. However, appropriations would actually be made, and expenditures would be shown in the annual administrative budget, only as scheduled.

The third step we propose is that Government discharge its responsibility for the unfunded liability attributable to legislation already enacted by authorizing permanent, indefinite appropriations to "peg" the trust fund at a predetermined level high enough to assure an ample margin of safety and confidence.

This means that in any fiscal year in which the Commission estimated that the balance in the fund by the end of the year would fall below that predetermined level, the Commission would so notify the Secretary of the Treasury. The Secretary would then have transferred from the general fund to the trust fund, as a Government contribution, the amount necessary to keep the trust fund balance at the required level of adequacy.

We propose that this level be the highest yearend balance the trust fund reaches under this recommendation or "employee equity," whichever is greater. Employee equity is the total amount of the retirement contributions made by, and still remaining to the credit of, employees and former employees.

We make this proposal for the dual purpose of insuring that there will always be on hand in the fund a balance at least equal to the amount that employees and former employees have contributed to but not received back from the fund, and of maintaining confidence in the integrity of the fund. That confidence might be impaired if the balance began to drop.

To summarize: Increases in normal cost would be met by increased employee and agency contributions under step 1. Unfunded liability increases due to future legislation would be met by Government appropriations under the 30-year schedule called for by step 2. Unfunded liability attributable to laws enacted before adoption of the financing proposal would be taken care of by direct transfers from the general fund to peg the retirement fund, as called for by step 3.

Employees would pay one-half the normal cost of present and newly authorized benefits. Government, by one method or other, would pay all other costs.

The net result of this financing proposal is shown graphically on pages 16 and 17 of the booklet. Income would keep pace with outgo. The trust fund balance, instead of dropping to zero, would be maintained at a sound, safe level.

If there is no additional legislation that increases benefits for already retired employees, or for those who retire in the future, and no general pay increases—status quo, in other words—this proposal would require these actions:

Under step 1, an increase in contribution rates for both employees and agencies, to bring contributions up to a level sufficient to cover the full normal cost of present benefits; and

Under step 3, direct Government contributions from the general fund, beginning around 1975, to peg the retirement trust fund at its estimated peak of \$21.4 billion, so that the balance will never drop.

If future legislation adds to the unfunded liability, through general pay raises or otherwise, step 2 of the proposal would also become effective. It would require Government payments, in accordance with the 30-year schedule, to cover those newly created increases in the unfunded liability.

Practically speaking, all three steps will be necessary, because normal costs of the system are already underfinanced, we already have an unfunded liability due to laws previously enacted, and pay raises and retirement liberalizations will assuredly be enacted in the future, as they have been regularly in the past. Page 18 of the booklet graphically shows a financing picture based on these assumptions.

As illustrated, total annual income to the fund in the year 2015 would be \$6.9 billion, the amount needed to make benefit payments in that year. Of this amount, employees would be paying \$1.3 billion through payroll deductions, and their agencies would be paying the same amount in matching contributions. Interest earned on the invested retirement fund would produce an additional \$700 million. Direct transfers from the general fund to the trust fund, made under the permanent indefinite authority to peg the trust fund, would produce the remaining \$3.6 billion per year. Government payments under the 30-year amortization schedule would have been made in the meantime but would have been completed before the turn of the century.

With your permission, I would like to place this illustration in the record, together with three tables. The first table shows the estimated progress of the trust fund under present financing. The second illustrates progress under the proposed financing method, assuming no further liberalizations and no general pay raises. The third is presented to show results under the proposed financing method, assuming both future liberalizations and further cost-of-living adjustments resulting from legislation already on the books.

Mr. DANIELS. Without objection, the three tables will be incorporated in the record at this point.
(The tables referred to are as follows:)

TABLE 1.—*Estimated progress of the fund, assuming agency contributions matching employee deductions at 6½ percent, plus direct appropriations when needed to meet benefit payments*

[In millions]

Fiscal year	Employee deductions and deposits	Government payments		Interest at 3½ percent	Total receipts	Benefit payments	Balance in fund at end of year
		Agency contributions	Direct appropriations				
1965							\$15,601
1966	\$1,113	\$1,097	\$67	\$546	\$2,823	\$1,688	16,736
1967	1,155	1,140	73	594	2,962	1,945	17,753
1968	1,155	1,140	(1)	624	2,919	2,121	18,551
1969	1,155	1,140		650	2,945	2,278	19,218
1970	1,155	1,140		670	2,965	2,445	19,738
1971	1,155	1,140		685	2,980	2,618	20,100
1972	1,155	1,140		695	2,990	2,796	20,294
1973	1,155	1,140		698	2,993	2,977	20,310
1974	1,155	1,140		696	2,991	3,163	20,138
1975	1,155	1,140		686	2,981	3,354	19,765
1976	1,155	1,140		670	2,965	3,555	19,175
1977	1,155	1,140		646	2,941	3,750	18,366
1978	1,155	1,140		614	2,909	3,940	17,335
1979	1,155	1,140		575	2,870	4,125	16,080
1980	1,155	1,140		528	2,823	4,304	14,599
1981	1,155	1,140		473	2,768	4,491	12,876
1982	1,155	1,140		409	2,704	4,665	10,915
1983	1,155	1,140		338	2,633	4,828	8,720
1984	1,155	1,140		258	2,553	4,979	6,294
1985	1,155	1,140		171	2,466	5,118	3,642
1986	1,155	1,140		76	2,371	5,240	773
1987	1,155	1,140	2,285		4,580	5,353	
1988	1,155	1,140	3,161		5,456	5,456	
1989	1,155	1,140	3,255		5,550	5,550	
1990	1,155	1,140	3,339		5,634	5,634	
1991	1,155	1,140	3,404		5,699	5,699	
1992	1,155	1,140	3,464		5,759	5,759	
1993	1,155	1,140	3,520		5,815	5,815	
1994	1,155	1,140	3,571		5,866	5,866	
1995	1,155	1,140	3,618		5,913	5,913	
1996	1,155	1,140	3,656		5,951	5,951	
1997	1,155	1,140	3,691		5,986	5,986	
1998	1,155	1,140	3,725		6,020	6,020	
1999	1,155	1,140	3,755		6,050	6,050	
2000	1,155	1,140	3,783		6,078	6,078	
2001	1,155	1,140	3,808		6,103	6,103	
2002	1,155	1,140	3,831		6,126	6,126	
2003	1,155	1,140	3,851		6,146	6,146	
2004	1,155	1,140	3,869		6,164	6,164	
2005	1,155	1,140	3,885		6,180	6,180	
2006	1,155	1,140	3,894		6,189	6,189	
2007	1,155	1,140	3,903		6,198	6,198	
2008	1,155	1,140	3,912		6,207	6,207	
2009	1,155	1,140	3,921		6,216	6,216	
2010	1,155	1,140	3,929		6,224	6,224	
2011	1,155	1,140	3,941		6,236	6,236	
2012	1,155	1,140	3,950		6,245	6,245	
2013	1,155	1,140	3,958		6,253	6,253	
2014	1,155	1,140	3,963		6,258	6,258	
2015 and after	1,155	1,140	3,967		6,262	6,262	

¹ Presumes legislative action removing the requirement for appropriations to continue benefits provided by Public Law 87-793, effective from and after fiscal year 1968.

TABLE 2.—Estimated progress of the fund under proposed financing, assuming current benefit and pay levels (Dec. 31, 1966)

[Dollar amounts in millions]

Fiscal year	Employee deductions and deposits		Government payments			Interest at 3½ percent	Total receipts	Benefit pay-ments ¹	Balance in fund at end of year
	Amount	As percent of pay-roll	Agency contribu-tions		Direct Treasury deposits, "peg-ging"				
			Amount	As percent of payroll					
1965									\$15,601
1966	\$1,113	6½	\$1,097	6½	¹ \$67	\$546	\$2,823	\$1,688	16,736
1967	1,155	6½	1,140	6½	173	594	2,962	1,945	17,753
1968	1,199	7	1,184	7		626	3,009	2,121	18,641
1969	1,243	7	1,228	7		656	3,127	2,278	19,490
1970	1,243	7	1,228	7		683	3,154	2,445	20,199
1971	1,243	7	1,228	7		704	3,175	2,618	20,756
1972	1,243	7	1,228	7		721	3,192	2,796	21,152
1973	1,243	7	1,228	7		731	3,202	2,977	21,377
1974	1,243	7	1,228	7		736	3,207	3,163	21,421
1975	1,243	7	1,228	7	149	734	3,354	3,354	21,421
1976	1,243	7	1,228	7	353	731	3,555	3,555	21,421
1977	1,243	7	1,228	7	552	727	3,750	3,750	21,421
1978	1,243	7	1,228	7	745	724	3,940	3,940	21,421
1979	1,243	7	1,228	7	933	721	4,125	4,125	21,421
1980	1,243	7	1,228	7	1,115	718	4,304	4,304	21,421
1981	1,243	7	1,228	7	1,306	714	4,491	4,491	21,421
1982	1,243	7	1,228	7	1,483	711	4,665	4,665	21,421
1983	1,243	7	1,228	7	1,649	708	4,828	4,828	21,421
1984	1,243	7	1,228	7	1,802	706	4,979	4,979	21,421
1985	1,243	7	1,338	7	1,944	703	5,118	5,118	21,421
1986	1,243	7	1,328	7	2,068	701	5,240	5,240	21,421
1987	1,243	7	1,228	7	2,183	699	5,353	5,353	21,421
1988	1,243	7	1,228	7	2,288	697	5,456	5,456	21,421
1989	1,243	7	1,228	7	2,383	696	5,550	5,550	21,421
1990	1,243	7	1,228	7	2,469	694	5,634	5,634	21,421
1991	1,243	7	1,228	7	2,535	693	5,699	5,699	21,421
1992	1,243	7	1,228	7	2,596	692	5,759	5,759	21,421
1993	1,243	7	1,228	7	2,653	691	5,815	5,815	21,421
1994	1,243	7	1,228	7	2,705	690	5,866	5,866	21,421
1995	1,243	7	1,228	7	2,753	690	5,913	5,913	21,421
1996	1,243	7	1,228	7	2,791	689	5,951	5,951	21,421
1997	1,243	7	1,228	7	2,827	688	5,986	5,986	21,421
1998	1,243	7	1,228	7	2,861	688	6,020	6,020	21,421
1999	1,243	7	1,228	7	2,892	687	6,050	6,050	21,421
2000	1,243	7	1,228	7	2,920	687	6,078	6,078	21,421
2001	1,243	7	1,228	7	2,946	686	6,103	6,103	21,421
2002	1,243	7	1,228	7	2,969	686	6,126	6,126	21,421
2003	1,243	7	1,228	7	2,990	685	6,146	6,146	21,421
2004	1,243	7	1,228	7	3,008	685	6,164	6,164	21,421
2005	1,243	7	1,228	7	3,024	685	6,180	6,180	21,421
2006	1,243	7	1,228	7	3,033	685	6,189	6,189	21,421
2007	1,243	7	1,228	7	3,043	684	6,198	6,198	21,421
2008	1,243	7	1,228	7	3,052	684	6,207	6,207	21,421
2009	1,243	7	1,228	7	3,061	684	6,216	6,216	21,421
2010	1,243	7	1,228	7	3,069	684	6,224	6,224	21,421
2011	1,243	7	1,228	7	3,081	684	6,236	6,236	21,421
2012	1,243	7	1,228	7	3,090	684	6,245	6,245	21,421
2013	1,243	7	1,228	7	3,098	684	6,253	6,253	21,421
2014	1,243	7	1,228	7	3,104	683	6,258	6,258	21,421
2015 and after	1,243	7	1,228	7	3,108	683	6,262	6,262	21,421

¹ Special appropriations required to continue benefits provided by Public Law 87-793. Presumes legislative action removing this requirement from and after fiscal year 1968.

TABLE 3.—*Estimated progress of the fund under proposed financing, assuming liberalizations that increase normal costs by ½ percent of payroll and the unfunded liability by \$5,000,000,000*

(Dollar amounts in millions)

Fiscal year	Employee deductions and deposits		Government payments				Interest at 3½ percent	Total receipts	Benefit pay-ments ¹	Balance in fund at end of year
			Agency contri-butions		Direct Treasury deposits, "pegging"	30-year increasing amorti-zation				
	Amount	As per cent of payroll	Amount	As per cent of payroll						
1965										\$15,601
1966	\$1,113	6½	\$1,097	6½	² \$67		\$546	\$2,823	\$1,688	16,736
1967	1,155	6½	1,140	6½	² 73		594	2,962	1,945	17,753
1968	1,221	7¼	1,206	7¼		\$5	627	3,059	2,121	18,691
1969	1,287	7¼	1,272	7¼		10	659	3,228	2,283	19,636
1970	1,287	7¼	1,272	7¼		15	689	3,263	2,453	20,446
1971	1,287	7¼	1,272	7¼		20	715	3,294	2,634	21,106
1972	1,287	7¼	1,272	7¼		25	735	3,319	2,819	21,606
1973	1,287	7¼	1,272	7¼		30	749	3,338	3,003	21,941
1974	1,287	7¼	1,272	7¼		35	757	3,351	3,192	22,100
1975	1,287	7¼	1,272	7¼		40	760	3,382	3,382	22,100
1976	1,287	7¼	1,272	7¼	23	45	756	3,595	3,595	22,100
1977	1,287	7¼	1,272	7¼	235	50	753	3,803	3,803	22,100
1978	1,287	7¼	1,272	7¼	441	55	749	4,004	4,004	22,100
1979	1,287	7¼	1,272	7¼	641	59	746	4,201	4,201	22,100
1980	1,287	7¼	1,272	7¼	837	59	743	4,391	4,391	22,100
1981	1,287	7¼	1,272	7¼	¹ 1,025	64	743	4,588	4,588	22,100
1982	1,287	7¼	1,272	7¼	1,221	69	739	4,773	4,773	22,100
1983	1,287	7¼	1,272	7¼	1,404	74	736	4,947	4,947	22,100
1984	1,287	7¼	1,272	7¼	1,576	79	733	5,108	5,108	22,100
1985	1,287	7¼	1,272	7¼	1,735	84	730	5,258	5,258	22,100
1986	1,287	7¼	1,272	7¼	1,882	89	728	5,384	5,384	22,100
1987	1,287	7¼	1,272	7¼	2,005	94	726	5,504	5,504	22,100
1988	1,287	7¼	1,272	7¼	2,122	99	724	5,618	5,618	22,100
1989	1,287	7¼	1,272	7¼	2,233	104	722	5,726	5,726	22,100
1990	1,287	7¼	1,272	7¼	2,338	109	720	5,829	5,829	22,100
1991	1,287	7¼	1,272	7¼	2,438	114	718	5,913	5,913	22,100
1992	1,287	7¼	1,272	7¼	2,518	119	717	5,998	5,998	22,100
1993	1,287	7¼	1,272	7¼	2,600	124	715	6,083	6,083	22,100
1994	1,287	7¼	1,272	7¼	2,681	129	714	6,168	6,168	22,100
1995	1,287	7¼	1,272	7¼	2,762	134	713	6,254	6,254	22,100
1996	1,287	7¼	1,272	7¼	2,845	139	711	6,368	6,368	22,100
1997	1,287	7¼	1,272	7¼	2,956	144	709	6,468	6,468	22,100
1998	1,287	7¼	1,272	7¼	3,052	149	708	6,556	6,556	22,100
1999	1,287	7¼	1,272	7¼	3,293		704	6,629	6,629	22,100
2000	1,287	7¼	1,272	7¼	3,368		702	6,690	6,690	22,100
2001	1,287	7¼	1,272	7¼	3,430		701	6,715	6,715	22,100
2002	1,287	7¼	1,272	7¼	3,455		701	6,738	6,738	22,100
2003	1,287	7¼	1,272	7¼	3,479		700	6,759	6,759	22,100
2004	1,287	7¼	1,272	7¼	3,500		700	6,777	6,777	22,100
2005	1,287	7¼	1,272	7¼	3,518		699	6,793	6,793	22,100
2006	1,287	7¼	1,272	7¼	3,535		699	6,802	6,802	22,100
2007	1,287	7¼	1,272	7¼	3,544		699	6,811	6,811	22,100
2008	1,287	7¼	1,272	7¼	3,553		699	6,820	6,820	22,100
2009	1,287	7¼	1,272	7¼	3,562		699	6,829	6,829	22,100
2010	1,287	7¼	1,272	7¼	3,571		699	6,837	6,837	22,100
2011	1,287	7¼	1,272	7¼	3,579		698	6,849	6,849	22,100
2012	1,287	7¼	1,272	7¼	3,592		698	6,858	6,858	22,100
2013	1,287	7¼	1,272	7¼	3,601		698	6,866	6,866	22,100
2014	1,287	7¼	1,272	7¼	3,609		698	6,871	6,871	22,100
2015 and after.	1,287	7¼	1,272	7¼	3,614		698	6,875	6,875	22,100
					3,618					

¹ Including transfer-of-credit payments to OASDI trust fund.

² Special appropriations required to continue benefits provided by Public Law 87-793. Presumes legislative action removing this requirement from and after fiscal year 1969.

Mr. MACY. Thank you, Mr. Chairman.

The proposal we are presenting today is one of many different ways the financing problem might be dealt with, and each method has its pros and cons. It is our judgment that this particular approach will identify, recognize, and meet full costs of future changes; will minimize the impact of these costs on the administrative budget; will control further growth of the unfunded liability; will keep the fund solvent, yet prevent an excessive build-up of its balance in advance of actual need for the money; and—most important to annuitants and to us—will assure that there is always enough money in the fund to permit issuance of annuity checks, in full and on time, without awaiting appropriation action to provide funds for payments already due. Its impact on the administrative budget will be sudden and sharp, beginning around 1975, but that impact will nevertheless be far less drastic than if present financing continues unchanged.

H.R. 10912 includes two additional items which are outside the basic proposal for improving financing of the system but which are desirable. One would make the retirement fund available for payment of the Commission's expenses in administering retirement laws. Such expenses are now being paid from the fund under appropriation authority, but substantive legislation is needed and the House Appropriations Committee has urged that we seek it promptly.

The second item would merge into one the civil service and the foreign service retirement and disability funds, but not the benefit structure or the administration of the two systems. Both funds are experiencing the same difficulties, for the same reasons. The foreign service retirement and disability system is so small in comparison with the civil service system that merging the funds can have no significant actuarial effect on financing of the larger system.

Mr. DANIELS. At this point, could you give us an idea what the amount of money is involved there?

Mr. MACY. The amount of money in the foreign service—Mr. Rud-dock, would you—

Mr. RUDDOCK. The unfunded liability of that system, the figure that would compare to our \$48 billion, is around \$250 million. While the problems are quite similar, the size of the foreign service liability is such that merging the two funds would not add appreciably to the financing problem of the civil service retirement system, but the foreign service financing problem would disappear.

Mr. MACY. In closing, Mr. Chairman, let me reemphasize a few points about which there has been a considerable amount of misunderstanding: Under our proposal—

Employees would not pay any part of the cost of benefit increases for persons already retired, or assume any part of the unfunded liability, or make up any past shortcomings in Government contributions;

General pay raises, though they increase the unfunded liability, would not trigger increases in agency or employee contribution rates;

Government would be paying more than half the cost of the retirement system—it would be paying 50 percent of normal costs and would be covering all of the existing unfunded liability plus any new unfunded liability created by future legislation.

Finally, the retirement system cannot be liberalized in any way without incurring additional costs. These additional costs must be met somehow.

Mr. Chairman, the precise method of approach to solution of this retirement financing problem is, to me, far less important than getting started. The longer we delay, the larger is the problem we have to deal with. I urge, therefore, that some action be taken reasonable soon to solve this problem—to maintain confidence in the soundness of the fund and to assure that the necessary money is available when needed to pay the annuities of Government's retired employees and their survivors.

I shall be glad to provide any additional information you desire and to answer any questions you may have.

Mr. DANIELS. Mr. Commissioner, I want to thank you for a very fine presentation here this morning. You brought the problem very clearly to us. Now, I would like to ask you what contribution rate increase is being sought in this proposal?

Mr. MACY. Mr. Chairman, we are not requesting any specific increase. What we are asking is that the Commission have authority to set rates at a level sufficient to cover normal costs of the retirement system. As I explained—and I would like to offer the explanation once again—normal cost is that average percentage of annual pay of new employees that needs to be contributed and invested at interest throughout their service in order to accumulate sufficient funds to pay their benefits.

If our request for authority to set rates at a level that covers normal cost is granted, contribution rates would be adjusted each January as necessary to cover whatever the normal cost is at that time. Normal cost of the system is now, as I indicated earlier, 13.86 percent of pay. If this proposal were passed now, or in the early future, and the 50-50 cost-sharing ratio were maintained as proposed, a rate increase of one-half of 1 percent for employees, and an equal amount for their agencies, would be required the following January.

If normal costs should go up significantly because of further retirement liberalization, the contribution rate increase would be correspondingly higher. Under this proposal the normal cost would be ascertained each year, and an adjustment made automatically so that on a 50-50 sharing basis, normal cost would be fully covered.

Mr. DANIELS. Now, Mr. Commissioner, what is the employee going to get for the initial increase of one-half of 1 percent in his contribution.

Mr. MACY. I think the most direct and simple way to respond to that is that he will cover the benefit he now has. Since the contribution rate of 6½ percent was authorized in 1956, there have been a number of legislative enactments which have had the effect of increasing the normal costs of the system.

To be specific, Public Law 86-622, July 12, 1960, provided additional annuity for employees with long service.

Public Law 87-350, October 4, 1961, allowed reinstatement of disability annuity after recurrence of disability or loss of earning capacity.

Public Law 87-793, October 11, 1962, lowered the reduction in earned annuity to provide survivor benefits. A 55-percent widows benefit was authorized, and student child benefits were included.

Public Law 89-504, July 18, 1966, provided, as I am sure we all recall, for 60-20 and 55-30 retirement on full annuity. It raised student

child benefits through age 22. It provided for continuation of survivor benefits upon remarriage after age 60, and it provided for the elimination of the child dependency requirement.

Now, these four statutes in the period since 1956 have resulted in raising the normal costs from about 13 percent, which was adequately covered in 1956, to 13.86 percent, which is the normal cost at the present time.

Mr. DANIELS. In what amount has it increased the unfunded liability of the retirement fund?

Mr. MACY. The unfunded liability has grown from \$32.3 billion in 1961 to \$48.1 billion in 1967. It has been affected by a number of legislative items, but particularly by the pay increases that have occurred during this period. I have a list which I can provide for you, or I can read which sets forth some seven public laws during the period 1961-67 which have increased the unfunded liability beyond its normal expected increase. If we were to have no changes at all, the loss of interest on the fund would increase the unfunded liability more than a billion and a half dollars a year.

Mr. DANIELS. I would suggest that you put that statement in the record or, if you wish, you may read it.

Mr. MACY. All right. For fiscal year 1961, the amount of unfunded liability at June 30 was \$32.5 billion; in 1962 it was \$33.7 billion; in 1963, \$36 billion; in 1964, \$37.3 billion; in 1965, \$40 billion; in 1966, \$44 billion; and in 1967, \$48.1 billion.

A major reason for the growth of the unfunded liability for that period is loss of interest. In 1961 this was estimated at \$0.9 billion. It has risen—

Mr. DANIELS. What was that, 1951?

Mr. MACY. In 1961, at the beginning of this period that I have cited. The increase in unfunded liability attributable to loss of interest was \$900 million. That has grown in the 6-year period so that in 1967 the loss of interest amounted to \$1.6 billion. The other reasons are new and liberalized benefits and salary increases without full financing.

During the 1961-66 period the legislation accomplishing those changes were these: Public Law 87-114, July 31, 1961, made annuities for so-called forgotten widows and 10-percent annuity increases of 1958 permanent, notwithstanding lack of an appropriation.

Second, Public Law 87-793, October 11, 1962. This was the Salary Act of 1962. It included a 9.6 percent pay raise, including both the 1962 and 1964 phases of the increase. That bill also removed annuity increase ceilings, and provided additional 5, 4, 3, 2, and 1 percent annuity increases. It lowered reduction in earned annuity to provide survivor benefits. It provided a 55-percent widows' benefit. It extended student-child benefits. The cost of these changes in the retirement law are not reflected in the unfunded liability because in that one instance the annual cost is being met by special annual appropriations.

In the appropriation bill for the independent offices signed last week by the President, there is \$71 million appropriated for the trust fund in order to pay for that particular increase in benefits. It did not, however, take care of the liability resulting from the pay raise in that particular bill.

Third, Public Law 88-426, August 14, 1964, this was the Salary Reform Act of 1964 and called for a 4.2 percent pay raise.

Fourth, Public Law 89-205, September 27, 1965. That provided for a 4.6 percent cost-of-living annuity increase, plus an additional $6\frac{1}{2}$ -percent annuity increase for pre-1956 retirees, and an additional $1\frac{1}{2}$ -percent increase for others, also, earlier automatic cost of living adjustments in the future than had been previously authorized.

Fifth, Public Law 89-301, October 29, 1965, Salary Act of 1965, 3.6 percent pay raise.

Sixth, Public Law 89-314, November 1, 1965, extended time for qualifying for the 4.6-percent and $1\frac{1}{2}$ -percent increase under Public Law 89-205.

And finally, seventh, Public Law 89-504 of July 18, 1966, the Salary and Fringe Benefits Act of 1966, 2.9 percent pay raise. Also provided 60-20 and 55-30 retirement on full benefits; student-child benefits to age 22; continuation of survivor annuity upon remarriage after age 60; 10 percent annuity increases for widows and widowers of employees who died or retired before October 11, 1962; and elimination of child's dependency requirement.

So, Mr. Chairman, these seven statutes in varying ways and varying amounts increased the unfunded liability beyond the amount it was increased by loss of interest.

Mr. DANIELS. Will the pay bill recently passed by the House and now pending over in the Senate, if passed by that body and enacted into law, require an additional contribution?

Mr. MACY. It would not require any additional contribution in terms of normal cost. The normal cost will remain at 13.86 percent after the passage of that law. Passage of that bill will increase the unfunded liability because of the increase in annuities that will result from the higher high-five average salaries resulting from that bill. You can apply the formula that I gave you earlier in computing what the increase in unfunded liability will be from that pay raise.

The salary increase for this year is approximately \$660 million annually. Multiply that by $2\frac{1}{2}$ in order to determine what the increase in the unfunded liability will come to. It would be about a billion and a half.

Now, if step 2 in the proposal were to be applicable to this pay raise, it would mean that there would be an amortization schedule which would cover a 30-year period which would provide for the fund \$1,650 million over that period of time. The first payment in the first year would be \$6,684,000. This would increase arithmetically throughout the 30-year period until the final payment in the 30th year, which would be the year 1997, would be \$200,531,000. The total payment would be \$3,108 million.

Now the reason why that is so much higher than the increase in unfunded liability is the interest that would be paid over the period of amortization just as one would pay interest on a mortgage over a period of time. But the schedule is so designed as to provide the money in the fund in order to meet the expected payments that would flow from this increase, and it would avoid increasing the fund excessively in the earlier period after the effective date of this pay increase when the increased funds are not necessary to pay annuities.

Mr. DANIELS. Well, that brings me to this question. I notice in your schedule providing for 30-year payment that in the beginning the payments are relatively small, and then as each year passes, the

amounts to be contributed increase. Why do you have this varying scale of payments each year which progressively increases instead of a constant fixed payment each and every year over the 30-year period?

Mr. MACY. The reason we did this really falls into two areas. One, by handling it in this fashion the money is contributed more in relation to the demand from the fund for annuity expenditures that are reflective of this increase in salary, so that there is not an increased amount of money in the fund that is not going to be drawn upon in the relatively early future. And second, this was designed so that there would not be too heavy an impact on the administrative budget in the early stages when the funds were not required in order to meet annuity provisions.

Now, you will notice, Mr. Chairman, and I believe you will have testimony on this, that the Comptroller General, in contrast to this has recommended that there be a level payment made over a 20-year period. He prefers that method of financing. The impact—

Mr. DANIELS. What is your position, then, on the recommendation that will be made by the Comptroller General?

Mr. MACY. I prefer this method.

Mr. DANIELS. The one to which you have already testified?

Mr. MACY. The one that is in H.R. 10912.

Mr. THOMPSON. Will the gentleman yield?

Mr. DANIELS. Yes.

Mr. THOMPSON. Basically what the Comptroller General is suggesting then is putting more money in the fund than is actually needed to meet the obligations. What you are proposing is to pay only enough money in so that when there is a need to draw it down, that money will be available to draw down, rather than paying in a large sum, which will sit there and not be needed until a later date?

Mr. MACY. Exactly. And have money sitting there and drawing interest from the Government to itself in order to increase the fund. Now, one point I should add in commenting on the Comptroller General's views—and I would rather have him develop his views—is that he would prefer a 20-year period of amortization rather than the 30-year period we have used here. We have used 30 years because we feel it is reflective of a career within the service, and that if you base this increase on the expected career of the employee coming in, this would be a reasonable way of estimating the impact of cost over a period of time.

Mr. DANIELS. Our time is growing short, and I do not want to monopolize all the time. I would like to give my colleagues an opportunity to ask a few questions. However, if we are unable to complete this questioning and answering period today, I would like to request you to return at some future date.

Mr. MACY. Be happy to, at any time at your convenience, Mr. Chairman.

Mr. DANIELS. The legislation pending before us does not do anything with respect to the unfunded liability of \$48.1 billion to which you have already testified. We would not be doing anything to erase that deficit in this legislation?

Mr. MACY. You are not doing anything to reduce or liquidate that deficiency.

Mr. DANIELS. That is going to remain as is?

Mr. MACY. That remains as is.

Mr. DANIELS. But in your testimony, you have made mention to a term known as pegging. Now, you explain to us what you mean by pegging and what the intent is of this pegging.

Mr. MACY. Right. The term "pegging" in the third-step proposal is used to establish a level in the fund below which the fund would not fall, in order to guarantee the integrity of the fund and to insure prompt and full payment of the annuities as they arise. The pegging that we recommend is a pegging at the high point of the fund. The fund is continuing to grow. It begins to tip over and come down in 1947, so \$21.4 billion is our estimate as to what that peak is. That amount would also more than cover the employee equity in the fund. We feel very strongly that the amount of money that the employees have put in the fund should remain intact, and—

Mr. DANIELS. You refer to—you mean the amount of money that the employees have contributed in the fund?

Mr. MACY. Have contributed in the fund and have not drawn upon in annuities subsequent to retirement. This would be the unexpended balance of the employees' contribution in the fund.

Mr. DANIELS. So in the event we were to liquidate this system, it is your intent, by pegging it at a certain level, that there would be sufficient money in the fund to pay each and every employee the full amount of his contribution?

Mr. MACY. That is right.

Mr. DANIELS. I would like to have my colleague from New York ask a question. If you don't object, I would like to split this time equally between you and Mr. Thompson.

Mr. HANLEY. Well, I thought I would ask for unanimous consent to proceed for an hour—

Mr. DANIELS. Suppose we split it up three ways, 5 minutes each.

As I said before, I know the time is short, and because of the importance of this legislation, it certainly is most important, I don't think we ought to deny the members the full opportunity—

Mr. MACY. I agree completely, and if you have not satisfied your questioning, I would be happy to return at any time convenient to you.

Mr. HANLEY. Thank you, Mr. Chairman.

Mr. MACY. I want to commend you on your fine statement. Obviously the Commission is thoroughly aware of the serious problems we have with this unfunded liability.

With respect to the last 6 years, when we point to an additional \$16 or \$17 billion added on to the fund, I would say that it is high time that the Congress moved in the direction of doing something about this serious problem. I think perhaps one of the reasons that hasn't been reflected upon this morning has been the consistent increase in the number of Federal employees.

I know a figure given me earlier this morning in our Position Classification Subcommittee indicated that as of August we had, I believe, 3,026,000 employees in the Federal family. And we recognize that with every employee we are really expanding upon the unfunded liability per the present system.

In view of the time restriction here, I will pose only a question or two. Initially the cost of administering the program, how much are we talking about on an annual basis?

Mr. MACY. The cost of administering—

Mr. HANLEY. The Government's cost of administering the retirement program?

Mr. RUDDOCK. That is estimated at \$4,250,000 for the current year.

Mr. MACY. That amount of money is drawn from the fund under an appropriation authorization. But it is our recommendation here that this become a part of the substantive legislation.

Mr. HANLEY. Then this actually is not an out-and-out appropriation for the purpose of administering the fund, but it actually comes out of the fund itself?

Mr. MACY. But only in the last year. Prior to that it was always a direct appropriation.

Mr. HANLEY. I see. What was the reason for that change?

Mr. MACY. The change was that, as in other trust funds, the administrative cost should be drawn from the fund itself. This appeared to be a logical and businesslike way of dealing with this expense.

Mr. HANLEY. On page 10 you refer to any new groups brought into the system. For example, assuming the civilian employees of the National Guard are brought into the system—and I happen to be one of those who thinks they should be in the system—how do we propose to treat the situation like this insofar as the retirement program is concerned?

Mr. MACY. If we brought them into the system and we were to give them credit for their past service, it would be necessary under this plan to provide for a schedule to meet the increased unfunded liability over a period of time.

Otherwise, this becomes another factor of increase. The philosophy behind this bill is to avoid any increase in the unfunded liability, so that if new groups were brought into coverage, it would have to be on the basis that the Government would have to meet that cost.

Under our proposal the cost would be met through this amortization schedule over a period of time.

Mr. HANLEY. I see. Has the Commission ever given consideration to the possibility of the system being administered through private underwriters?

Mr. MACY. No; I don't believe so. The system as it was set up in 1920 called for a trust fund and by statute restricted the investments in the fund to Treasury securities. I confess to occasionally casting a covetous eye toward some pension funds that are able to use equities in the open market and get a higher return. But the public policy has been so clear on this that I don't think we have been adventuresome enough to consider handling it in any other way.

In some public jurisdictions, there is authorization to invest all or a portion of the funds in non-Government issues, but that has not been the case in this fund.

Mr. HANLEY. Well, it would seem to me in view of the problem that we have here that it might be worth while to explore the possibility of underwriters from the private sector on a pool basis. And when we consider the cost of administering the fund that we are talking about it is \$4 million plus per year.

Perhaps we might in the long run come out of it better insofar as the taxpayer is concerned. We might eliminate the problem that we have. I think most of us will agree that private underwriters have somewhat

of an uncanny way of investing wisely. And I do think that if this problem can't be resolved through the proposal that you have offered here today that some consideration should be given the possibility of having the system underwritten by private companies on a pool basis.

Mr. MACY. Mr. Ruddock, would you like to comment on that?

Mr. RUDDOCK. When the idea of investing in other than interest bearing securities in the United States has come up in the past, one of the thoughts that has come into consideration has been the effect of investments of this size on the economy. You are proposing a little different device. You are proposing that it be done through private industry, so there would be investments in private industry through private industry.

Mr. HANLEY. I can only assume that the effect—from the standpoint of the economy of the Nation—would be good.

Mr. RUDDOCK. I would like to say that in my opinion, so far as the administrative costs are concerned, I don't believe private industry could administer the system for the \$4,250,000 with which we will administer it this year.

Mr. HANLEY. I wouldn't profess to be an expert with respect to that aspect of it. But I simply do believe that it is imperative that we move in the direction of eliminating this problem. And as I have indicated, should the proposal that Mr. Macy has advanced here this morning not succeed, then let's look for another possibility.

Mr. MACY. We are very grateful to this committee for holding these hearings because this problem has been a hair shirt that we have been wearing at the Commission for quite some time. Annually the appropriations subcommittees give us a good healthy scrubbing on why we haven't come up with a solution to this problem.

Well, as you can see, any solution involves a great deal of money. Our feeling is that this is the best idea we have been able to devise after concentrated attention on this for a period of at least 10 years.

However, we don't claim this is the only answer, but we feel there needs to be this kind of discussion of the problem. And the best thinking should be assigned to the problem to see if we could find some solution that will keep us from having a further deterioration of the situation.

Mr. HANLEY. I salute your efforts, Mr. Chairman.

Mr. DANIELS. Mr. Commissioner, the cost of administering the fund this year is stated at \$41¼ million. And it comes out of the fund, is that true?

Mr. MACY. That is right.

Mr. DANIELS. Now, is the Government doing anything to reimburse the fund for that \$41¼ million?

Mr. MACY. No. This is viewed by the administration and by the appropriations committees as a proper charge against the fund.

Mr. DANIELS. Without making appropriations to reimburse the fund for that purpose?

Mr. MACY. No. This is in effect an appropriation from the fund to meet the administrative expenses of the program.

Mr. DANIELS. But if we were to increase the contribution by approximately a half percent from the employee and a half percent from the Government, making a total of 7 percent each to be contributed, that would be sufficient to cover the cost?

Mr. MACY. Yes, cost of administration is so small in terms of the total that it would have no effect.

Mr. HANLEY. Can you advise with respect to the Veterans' Administration how it administers its insurance program? Is it administered in an appropriative manner or does it come out of the fund itself?

Mr. RUDDOCK. My recollection on the national service life insurance is that the cost of administration does not come out of the insurance fund.

Mr. HANLEY. It is a direct appropriation within the VA budget?

Mr. RUDDOCK. That is my recollection of it.

Mr. HANLEY. Thank you.

Mr. DANIELS. Mr. Broyhill.

Mr. BROYHILL. Mr. Chairman, the present unfunded liability is \$48 billion plus. The fund balance is approximately \$17 billion, I believe.

Mr. MACY. That is right.

Mr. BROYHILL. This is sufficient at this time. This fund balance at this time is sufficient to cover the employee contributions that have been made to the fund, is that correct?

Mr. MACY. That is correct; yes, sir.

Mr. BROYHILL. And your proposal would be to maintain a fund balance, as I view these charts, approximating \$22 billion.

Mr. MACY. That is correct.

Mr. BROYHILL. And this would also cover the employee contribution that has been made?

Mr. MACY. It would.

Mr. BROYHILL. What about these unfunded liabilities?

Mr. MACY. You would continue to carry that, but would avoid increasing it unduly by the second step, which is the amortization table for paying off increased costs resulting from liberalization or pay increases.

Mr. BROYHILL. And the unfunded liability would depend upon future appropriations?

Mr. MACY. That is right. You would in effect set aside the unfunded liability and deal with the balance in the fund, and assure that the balance in the fund was sufficient to cover the employee equity which would always be sufficient to meet the needs of the fund—the needs of the current obligations.

Mr. BROYHILL. If this were enacted into law, you could recognize that the unfunded liabilities would continue to grow, which I assume they would.

Mr. MACY. That is right.

Mr. BROYHILL. As I view this, then, your proposal is that we just keep it under control?

Mr. MACY. That is right. Some recommendations, Mr. Broyhill, have been that the Government ought to appropriate the full amount of the unfunded liability and put it into the fund so that the fund would be level.

Well, this would be sound, conservative financing, but it would mean that a large sum of Federal resources would be tied up in the fund far in excess of the current needs or the—

Mr. BROYHILL. It would also mean that other programs of the Federal Government may have to be either delayed or cut out?

Mr. MACY. That is right. So there is a pragmatic note of realism in this proposal because it improves the financial picture, but without totally disrupting the rest of the fiscal picture of the Federal Government.

After all, this fund has to operate within the context of the total fiscal framework of the National Government.

Mr. DANIELS. Mr. Thompson.

Mr. THOMPSON. Mr. Chairman, I would like to follow the reasoning Mr. Hanley was putting forth and to develop it a little further. Would the amount of money we have in the program be sufficient to cover the employees' contributions and does this grant them any interest on their contributions or is it only the dollars that have been put in?

Mr. MACY. That is only the dollars that have been put in.

Mr. THOMPSON. And you are planning to peg this at a sufficient level that would be sufficient were we to liquidate the fund, at any time, to pay the employees the dollars they had put in without interest?

Mr. MACY. No, I believe that this would be covered.

Mr. THOMPSON. \$24 billion, I believe you are talking about.

Mr. RUDDOCK. \$21.4 billion actually would be large enough to cover an interest accumulation. But as a matter of law, the only interest that is payable to an individual on his own contribution is interest which has accrued before 1957 unless he is separated before he has completed 5 years of service.

There is no interest payable after 1956 on the account of any employee who has more than 5 years of service. So that interest is not a big factor.

Mr. THOMPSON. Now, following along with the thought that Mr. Hanley was proposing about using private underwriters for investing some of the funds, are we being fair to the Government employees? Are we being overly conservative by limiting this strictly to Government securities when we are anticipating only a three and a half percent return? It is obvious that concerns such as A.T. & T., Sears Roebuck, Delta Airlines, and others are able to invest their pension funds in other types of commercial stocks and bonds and equity funds which provide a much greater return and growth rate.

Would we have to charge 7 percent to the employee and 7 percent to the Government if you were given some flexibility in your investments by the Congress?

Mr. RUDDOCK. The normal costs would be less than 13.86 percent if we had a higher rate of income on the investment.

Mr. THOMPSON. Do you feel that we would be jeopardizing the security of an employee's retirement were we to pass legislation which would enable the fund to be invested in something other than Government bonds?

Mr. MACY. I think that is a fundamental question. We have always taken the position that the full faith and credit of the United States stands behind this fund, and that in the final analysis the Congress will appropriate funds to fulfill that faith and credit.

Mr. DANIELS. If the full faith and credit of the United States is pledged behind this fund, then, why is it necessary to do anything about the financing?

Mr. MACY. Because the view is that the fund is in a better and more responsive position if we start anticipating some of the funding for the future. This is a more systematic way and a more certain way of providing that faith and credit out of the trust funds.

As you can see from the tables, if we continue as we are, the Congress will eventually be faced with very heavy annual appropriations of \$3 billion in order to meet current obligations, because the fund will no longer exist.

Mr. DANIELS. What you are saying, then, Mr. Commissioner, is that this would be a more orderly and businesslike manner of handling it, is that right?

Mr. MACY. Right.

Mr. THOMPSON. Let me pursue this point a little further. Do you feel that it would be possible to invest in other than Government securities and not risk the stability of the fund?

Mr. MACY. Well, I would assume that whoever the trustees would be—at the present time it is the Secretary of the Treasury—would invest in such a conservative and careful manner that there would be the minimum degree of risk. But it seems to me that even with the greatest prudence, you are running a greater risk than if your investments are in the securities of the United States.

Mr. THOMPSON. But in all probability we can anticipate you would have more than three and a half percent return just looking at the private industry plans. When the pension plans are invested there, do you have any idea what is an average rate of return that the pension funds in private industry are producing?

Mr. MACY. I don't. But I know it is higher than our rate. I think the problem is that you would have significant fluctuations. I know that in my previous role as a trustee of a university, we changed our portfolio a good deal based upon the judgments that were given to us in order to get not only a higher yield, but a balanced yield on our endowment funds. It seems to me the same prudence would have to be exercised. But you would have a situation where you would have to make moves in the market.

And when you are dealing with as large a fund as this, what impact do these moves in the market have with respect to the total economic situation?

Mr. THOMPSON. Well, do you feel that the Treasury derives a benefit by being able to stabilize the market, so to speak, in that they have a large fund here where they can sell their bonds to the retirement fund at a rate of three and a half percent rather than having to go and sell them to the general public?

Mr. MACY. I think it is beneficial to the Treasury.

Mr. THOMPSON. So basically the Government is deriving a benefit by limiting the area in which you can invest these retirement funds. We are not doing this solely for the protection of the fund and to assure the security of the fund for the employees, but there is a second benefit that flows to the Department of the Treasury to control so to speak, the market price of their offerings by having a fund where they know they can put off at a certain price so many bonds or so many securities.

Mr. MACY. I think that is a secondary benefit to the Government. We recommended a change and the Congress revised the method by

which the interest rate is computed. Previously it was on the coupon value of the bonds. It is now on the basis of the average market rate for securities.

Mr. THOMPSON. Well, this being true, as future pay increases are presented to Congress, and if it is a four-and-a-half-percent increase, since there are other benefits that are derived by the Government, of course, I am about to ask you for an opinion as to how Congress should act, but do you feel that we should have a reluctance to put an additional sum on that to take care of the added costs that we would have for this pegging in here because the Government is deriving some other benefits?

Mr. MACY. On the pegging I would feel that what you are doing is having the Government pay all these costs.

Mr. THOMPSON. That is right.

Mr. MACY. There are some who argue that the employees should pay a larger share.

Mr. THOMPSON. So the Government is paying all of the pegging, actually. But they are deriving a benefit by virtue of the fact that there is a market for Government securities in this fund. But all of the pegging is paid by the Government basically as an additional appropriation in addition to the pay raise which, in effect, means when you have a four-and-a-half-percent pay raise, the cost to the Government is really more than four and a half percent because of the pegging? Is this correct?

Mr. MACY. The cost would not be directly related to the pegging in passing a pay increase. The additional costs would be in offsetting the increase in unfunded liability that would flow from—

Mr. THOMPSON. From the increase.

Mr. MACY. So what is proposed here in step 2 is that in a four-and-a-half-percent pay increase, there would be an amortization schedule for payment of the increase in the unfunded liability so that it would not show up as an increase. And we would hold the line on the unfunded liability.

Mr. THOMPSON. But because of this unfunded liability, any time we have a pay increase, the overall cost to the Government is going to be more than the apparent cost of four and a half percent?

Mr. MACY. That is correct. I have endeavored in my testimony on pay bills to remind the committees that the cost in increased expenditures for salaries for a particular fiscal year is not the total cost, but that the cost is going to show up in the retirement fund. It is going to show up in deferred payments for leave. It is going to show up in increased obligations for insurance and so on, so that we really need, on any pay legislation in the future, to look at the gross cost to the Government, not just the current payroll cost that results from the pay increase action.

Mr. THOMPSON. Thank you very much, Mr. Commissioner.

Mr. DANIELS. Thank you, Mr. Commissioner, and Mr. Ruddock. Your testimony was most interesting.

Mr. MACY. Thank you, sir. I appreciate your taking the time.

Mr. DANIELS. The subcommittee will stand adjourned until 10 a.m. tomorrow morning.

(Whereupon, at 12:10 p.m., the subcommittee was adjourned until 10 a.m. the next day.)

RETIREMENT FINANCING

THURSDAY, NOVEMBER 9, 1967

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON RETIREMENT, INSURANCE, AND HEALTH BENEFITS OF THE COMMITTEE ON POST OFFICE AND CIVIL SERVICE,

Washington, D.C.

The subcommittee met at 10:25 a.m., in room 210, Cannon House Office Building, Hon. Dominick V. Daniels presiding.

Mr. DANIELS. The Subcommittee on Retirement, Insurance, and Health Benefits will come to order.

The subcommittee is meeting this morning to continue taking testimony with respect to the financial condition of the civil service retirement and disability trust fund.

The retirement law provides for an independent Board of Actuaries, whose function is to report annually on the actuarial status of the system, to furnish its advice and opinion on matters referred to it, and to recommend to the Civil Service Commission and to Congress such changes as in the Board's judgment are necessary to protect the public interest and maintain the system on a sound financial basis.

The subcommittee is pleased to welcome a member of that Board this morning, Mr. Dorrance C. Bronson. Mr. Bronson is accompanied by the Chief Actuary of the Civil Service Commission, Mr. Maurice Brown.

Will you gentlemen step forward to the witness table?

Mr. Bronson, you may proceed.

STATEMENT OF DORRANCE C. BRONSON, MEMBER, BOARD OF ACTUARIES, CIVIL SERVICE RETIREMENT SYSTEM, ACCOMPANIED BY MAURICE BROWN, CHIEF ACTUARY, CIVIL SERVICE COMMISSION

Mr. BRONSON. Mr. Chairman, gentlemen, I am very pleased to be here speaking—while I don't say so specifically, I am, in effect, speaking in favor of this bill or any other bill that does something beyond the lack of action that has been so long obtaining under this Civil Service funding.

Year after year the Board of Actuaries has recommended that funding be strengthened, that some funding program for the past be developed, but no action proceeded therefrom.

I am happy to find your committee taking up something which does have some action in it. And, while I might characterize my statement here as one which cleaves a little technically to some of the actuarial angles and would clarify the bill in certain ways, nevertheless we are in favor of this sort of action.

Mr. DANIELS. When you refer to "the bill," are you referring to H.R. 10912?

Mr. BRONSON. I am, sir.

I don't know whether you wish me to read the whole statement verbatim, or to use some elision in summarizing some of these points.

Mr. DANIELS. Mr. Bronson, you may read from the statement, or if you prefer, you may offer the statement for the record and it will become part of the record, without objection, and you may testify extemporaneously and give any other views that you desire. You may desire to summarize what is in your statement and supplement it with whatever views you have this morning.

Mr. BRONSON. May I combine those offers? I mean, take choices between them, such as summarizing some paragraphs, but reading the ones that I would like to be sure are in the record?

Mr. DANIELS. You may proceed as you see fit.

At this time your statement will become a part of the record, if there is no objection.

(The complete statement follows:)

PREPARED STATEMENT OF DORRANCE C. BRONSON, MEMBER, BOARD OF ACTUARIES,
CIVIL SERVICE COMMISSION

A. BACKGROUND

Mr. Chairman and Members of the Subcommittee, while my extended dossier is available, if need be, it may suffice merely to state, (1) that I am a member of a number of national and international professional actuarial organizations. Extended written examinations, lasting several years, are required by some, while others depend on documentary evidence of a considerable background of actuarial professional practice amongst the public; and (2) that I have served on the C.S.C.'s Board of Actuaries for some time now (since about April 1962), which Board was established by law on May 22, 1920; see Sec. 16(g) of the Civil Service Retirement Act.

B. NOT BOARD'S STATEMENT

I should emphasize that my statement, here, necessarily is that of an individual consulting actuary and not an expression as a Member of the Board itself, in the formal sense. Time did not permit full clearance with the two other Members; I did, however, convey to them orally, by long distance telephone, an outline and gist of my remarks. There was no dissent forthcoming and, hence, while I take the responsibility, I feel that more than a modicum of evidence has accrued to anticipate acceptability by the Board as a whole of this statement, the body of which I now present.

C. CAPSULE SKETCH OF BILL ON MY UNDERSTANDING—CERTAIN QUESTIONS TO FOLLOW

To improve the long deterioration in funding for the C.S.R. Act, H.R. 10912 (June 15, 1967) has been developed by the C.S.C. utilizing portions of the Cabinet Committee's Report to the President of Feb. 15, 1966. Mr. Macy will have fully described the proposals of the Bill for instituting action counter to the funding deterioration I mention. This action comprises a triple-set of funding devices, each quite different, actuarially, from the other. Just to identify them, by my interpretation, the first is to assure the meeting of "normal cost" (as defined) by matched employee-agency contributions; the second is in planning to meet the costs for *new* unfunded liability through an increasing 30-year schedule written into the bill for amortizing said liability; and the third funding prong lies in a plan of preventing either the fund's existing unfunded liability or any future liability which might appear, from increasing; setting the minimum at the previous year's figure is called "pegging", which would meet this objective; (also, an alternative "pegging" if higher, is stated as keeping abreast of the appropriate "employee equity", as defined).

D. MY STATEMENT'S CONTENT

This paragraph outlines certain of my testimony which explores the purpose and envisioned operation of my understanding of the bill, via my questions, mathematical illustrations, commentary, constructive proposals, etc. I shall strive for brevity; to that end, and from my first draft, I eliminate or shorten portions which Mr. Macy, preceding will have covered adequately. Indeed, the caveat for me to observe is that of keeping within the boundaries of actuarial sciences and not go into matters extraneous thereto.

E. A FEW OF MY LESSER POINTS

I have certain notes on topics or language in the bill which I feel warrant inclusion in this statement. These are classified as being of lesser importance relative to some I mention later. Briefly is an enumeration of one category of these "lesser" points, called "trip tik", because of the ease of the saying.

(i) On p. 2 of the Bill, in definition (19), line 10, I would suggest for accuracy and full clarity that the word "future" be inserted before the word "benefits". This definition involves the concept of "present value" which can encompass and evaluate both payments of the past and those ahead; indeed, in lines 10 and 11, reference is made to benefits payable to *former* employees. While it is doubtful that anyone would mistake the "forward view" intended in (19), this inserted word would clinch it. (As allied to my point, note in line 15 that the sole use of the word "future" puts a "fix" on the intention.)

(ii) On the same p. 2, same (19), in line 11, I believe the 1st letter of "members" should be capitalized.

(iii) On the same p. 2, on the last line (within definition (20)) natural questions concern whether "lump-sum credits" and "voluntary contribution accounts" have been defined in the basic Act. I find the former very clearly defined there, but not the latter. It turns out that though not in the definitions of the basic Act, in Sec. 12 thereof the description of the term "voluntary contribution accounts" is so adequately complete as to constitute a definition or better. Taking up certain more substantial points, it is important to note that the employee contributions generating "lump-sum credits" accrue interest at a 4% rate to 12/31/47 and, then, 3% to 12/31/55; in contrast, the voluntary contribution accounts have had 3% accruals all the way and these still hold at that rate of improvement.

(iv) Re the operation of the "voluntary contribution accounts", just discussed, if any of said 3% interest accrues on the "principal" beyond the dates on which voluntary annuity payments commence, then for any final settlement, the *reduction* called for in Sec. 12 of the basic act should be comprised of the voluntary annuity payments to date of settlement plus 3% compound interest thereon from each annuity due date to date of settlement. (However, I believe I can read portions of Sec. 12 which lead me to the conclusion that interest stops accruing on the account at retirement date.) Hence, while these "lump-sum credits" and "voluntary contribution accounts" questions appear to have resolved themselves, leaving definition (20) of the bill unchanged, by analysis of it, as above, did seem an advisable precaution.

F. NORMAL COST

There are four pertinent points to mention for this topic when used in regular parlance and not as a bizarre entity.

1. In Sec. 1 of the CSR Act, there are 28 definitions or descriptions; the term "Normal Cost" is not among them, either now or earlier (its earliest use in the Act was circa 1956). Despite no definition, the Board of Actuaries in Sec. 16 of the Act, is directed to make a report which includes the term "Normal Cost". To meet the need of using this term, not clarified in the Act, the Board developed its own definition thereof, unilaterally, but on a basis it felt to be in consonance with the intent of the Act. Quoting from the Board's latest printed report for the period ending 6/30/63, we find: "The normal contribution rate is the average percentage of the salaries of new employees that is required to be paid into the fund from the time they enter service until they leave service in order to accumulate sufficient funds to pay their benefits. Contributions at the normal contribution rate alone will not support the fund for present employees because there is an accrued liability in the fund for which no appropriations have been made and which is referred to as the 'deficiency'".

2. Unlike the current Act, the proposed Bill, H.R. 10912 *does* present a specific definition of "Normal Cost" as follows, in Definition (17) of the current Bill: "Normal cost means the entry-age normal cost computed by the Civil Service Commission in accordance with generally accepted actuarial practice and expressed as a level per centum of aggregate basic pay." As a description of "Normal Cost" this is satisfactory; one which is too narrow and incomplete is that which depends wholly on extreme youth or "frozen benefits". The words "Normal Cost" have evolved to comprehend other actuarial cost methods for currently due regular pension outlays, wide enough methods to allow general fluidity. The gamut, indeed, is now very wide: If one looks up Dr. McGill's Committee on Pension Terminology (Wharton School) he finds a definition of "Normal Cost" so flexible that an overnight action of the yeast at work in a new pension amendment could yield a wholly new cost method or methods falling within said Committee's definition for this term. For instance, even the one-year term cost only for the year would seem to be admissible; i.e., speaking of a specific discrete year, the full outlay paying for the full pension credited for the full year.

G. NORMAL COST—MORE EXAMPLES IN ACTUAL GOVERNMENT REPORTS

The Comptroller General reported to Congress April 24, 1967, on the subject of financing the CSR Act. Its accrued liability proposal will be mentioned later herein. But consonant with our current discussion on "Normal Cost", a definition thereof from the Cabinet Committee's Report is given in the footnote on page 3 of the cited document; this definition is, I feel, of the middle ground of the government types herein listed. It reads: "'Normal cost' means the cost of benefits being earned now and to be earned in the future, expressed as a level percentage of salary to be paid into the retirement funds each year for each employee in the service. These amounts, together with interest they earn when invested, will fully cover prospective cost of the benefits for employees and their survivors."

A pertinent description of "Normal Cost" has been suggested as representing sort of a legislative history and precedential citation relative to one view of the term used in one Act, developed from a committee reporting on a bill introduced in 1956, which became the CSR Act amendment, P.L. #854. In this case the important language of the committee's report reads as follows: "The total normal cost percentage is the estimated level percentage of the salaries of new employees and Members that would be required each year. They will be in the service to pay fully for all benefits to them and to their survivors."

It is obvious from the indications above and from viewpoints elsewhere regarding normal cost, that it is not of a ubiquitously standardized status. Normal cost varies in its composition not only from esoteric elements of fairly uniform plans such as these presently discussed Civil Service amendments whose structures vary considerably from the original basic Civil Service format. Having laid the above groundwork for the non-homogeneity of normal cost, I believe it feasible to follow with further questions even though the answers might disunify a certain aura I have sensed of Civil Service uniformity. Indeed, if one will check around a bit, he will find documented a considerable non-homogeneity of this term among private pension plans.

As a supplement, I will advert to a well-known study on various aspects of pension plans. I refer to what is called "The Report to the President on Private Retirement Pension Plans", sometimes called Cabinet Committee Report. It is well known that the Committee issuing this Report had convictions on the optimum standard of funding for private plans. That Committee proposed, *inter alia*, that the full price of current service pensions ought to be met each year and, in addition, a firmly scheduled program whereby an annual amortization of the full unfunded accrued liability be set up such that there would be payable the greater of (a) a program over approximately the balance of a person's remaining "work life" or (b) leveled over thirty years with interest included. These determinations would be subject to frequent certification by a qualified actuary. Parenthetically, may I state my basic opposition to governmental rules of this kind and to restrictive regulations in the field of private benefit plans; but if that is to be the route, let it avoid the crevasses.

H. "MAXIMUM" USE OF NORMAL COST ACCORDING TO ITS DEFINITION OR DESCRIPTION

The "minimum" interpretation of normal cost just given reminds me that this record *should* include a definition from the so-called Kaplan report, a well-known and quite comprehensive pension review prepared back in the early 1950's by the

"Committee on Retirement Policy for Federal Personnel",¹ chairmaned by Mr. H. Elliot Kaplan. The most complete description within the 5 resulting reports, I quote as follows:

"The normal cost is based on the precept that costs of retirement benefits are costs of production or service and, as such, are spread over the working lifetime of the employees. The normal cost assumes that constant rates of contribution by employees and employer are paid annually over the employees' entire working lifetimes from their dates of hire in order to pay for the costs of the plan.

"If the normal rates of contribution are fully paid each year as they become due, and the actuarial experiences (such as distribution of new entrants by age and sex, rates of salary increases, interest earnings, mortality, disability, retirement, etc.) coincide with the actuarial assumptions used in the determination of the cost estimates, the costs of the plan will be fully paid up for the benefits which then have been incurred. The assets accruing under the fund from such contributions will exactly equal the liabilities of the plan. Under these conditions, there will be no unpaid liabilities, or as they are referred to in tables, 'unfunded accrued liabilities.'"²

There are more heavily freighted statements of the term "normal cost", to wit, one extracted from certain C.S.C. literature on the instant bill:

"Full normal costs of present benefits and of all liberalizations authorized in the future be paid into the Fund currently via matching agency and employee contributions. Contribution rates would be raised, equally for employees and agencies, whenever liberalized eligibility requirements for benefits increase normal costs."³

Now a definition such as the last *must* be subject to the addition of more cost elements—apart from new legislation burdens than many other types. For instance, the effect of ages up the line must enter; also, effects of adverse actuarial experience must count to a greater degree (e.g., the raising of pay well above the assumed salary scale). For these reasons I feel that what is called, in several of the definitions, an "accepted actuarial practice" can be met only if these differential results in relation to "normal costs" are expected to occur. Through this expectation, it seems to me that the uniformity and stability so often viewed as an inherent trait of the method using normal cost can be justified. On this note, we may consider the foregoing definitions and uses of "normal cost" assembled in this paragraph (indeed, there were a number of additional ones which could have been inserted). In viewing this question, it is my conclusion that the differentials in character and in intention for "normal cost" are so wide as to make it impossible to treat the results, and the further application of the term, uniformly. For instance, the respective reserves emerging as a resultant of "normal cost" application can be so differently fashioned, one from another, by reason of what elements are includable in the term, and secondly, said reserve results are so modified by the interaction of those elements and the non-uniformity of the actuarial assumptions operating over the past as to cause the residual funds from different experience patterns to be quite non-homogeneous. Hence, it does not seem to me that the term "normal cost", standing for all the things we have listed for it above, is practice. Now, I am all in favor of bolstering the Civil service retirement funding by the use of some *normal cost method*, but I sincerely feel that such a usage of the term for the purposes of this bolstering requires considerably more precision as to just what it encompasses and as to just how it is intended to operate in practice, than has been yet spelled out in the Bill before us, or in the accompanying papers.

I. ANNUAL FIGURES REVISED ANNUALLY

The previous text dealt with a number of unrelated lesser matters through Section E. Section F, however, took up one of the three proposed new funding prongs, viz "Normal Cost". The gist of my findings in F was a suggestion to be more precise in the bill on that very important cost element.

But no matter how precise we get, experience under the plan will compel recognition now and then of actuarial faults, arising, on the one hand, within the reserve fund developed from previous normal cost payments and, on the other

¹ Including the Uniformed Services.

² Extracted from 3rd Report (dated 5/20/54) of "Retirement Policy for Federal Personnel": 83rd Congress, 2nd S.; Doc. #89, Pt. 3; H. E. Kaplan, Chairman.

³ Excerpt from letter concerning the bill released for information by Chairman Macy as of 6/8/67.

hand, faults will show up in the actual trend of the actuarial unfunded liability excluding (a) the voluntary program, (b) the schedule for new benefits amortization put into the Bill and (c) the financial aspects of the so-called "pegging".

J. THE SECOND PROPOSED FUNDING PRONG, VIZ, SCHEDULE FOR AMORTIZATION

(1) We have an odd situation here in the existence of an unfunded liability derived from earlier operations with an envisioned new series of liabilities which may well arise from future legislation. Concerning the existing liabilities and how they arose, it is germane to observe a series of annual figures covering some years back. I will confine myself only to the total Normal Cost Percentage comprising employee and employer obligations and, secondly, an expression of each year's actuarial deficiency, which stands as an obligation of the federal government; this item will be expressed in terms of millions of dollars. These two sets of historical amounts now follow in the two columns below, making up, in all, a period of 23 years (a few with missing data) :

Fiscal yearend	Total normal cost percentage	Deficiency liability (millions)	Fiscal yearend	Total normal cost percentage	Deficiency liability (millions)
1942.....	10.36	\$66.4	1955.....	10.92	\$397.0
1943.....	10.39	132.1	1956.....	13.50	519.9
1944.....	10.39	140.2	1957.....	13.50	538.5
1945 and 1946 missing.....	-----	-----	1958.....	13.83	833.5
1947.....	8.77	188.1	1959.....	13.83	850.9
1948.....	8.60	217.2	1960.....	13.83	934.3
1949.....	8.60	233.5	1961.....	13.83	976.4
1950.....	8.78	193.6	1962.....	13.83	1,009.8
1951.....	8.78	195.0	1963.....	13.49	1,320.8
1952.....	8.78	197.9	1964 missing.....	-----	-----
1953.....	8.78	199.5	1965.....	13.74	1,518.2
1954.....	11.15	324.2			

The dollar figures of Cols. (3) and (6), stand as liabilities of the past which have not been liquidated (and, indeed, may, perhaps, only be liquidated through benefit payment) but on the other hand, some development may turn up sometime by which certain of these unfunded dollar amounts will be paid off, or partially. One must also bear in mind that the mere fact that the percentage columns shown are, in a sense, an *à fait accompli*, does not mean that some unexpected upsetting actuarial disturbance may not disrupt what seems to be a solid accomplishment at this time.

(2) We must admit, especially with Cols. (3) and (6) above, that there here exists a probably permanent unfunded situation, which can get worse despite the proposed "pegging" and which can still get worse from some unfortunate experience in the actuarial assumptions underlying this part of the liability.

In consideration of the presently unfunded situation with a view—easily becoming true—that the aforesaid rather permanent "unfunded" can take on additional liabilities arising from legislated liberalizations of benefits or of conditions for receipt thereof; if such further erosion of the financial standing of the system eventualizes, the instant Bill has attempted a solution thereof in incorporating in toto a thirty-year amortization schedule which is computed as an arithmetical progression, e.g., assume a new million dollar piece of unfunded liability, assume $3\frac{1}{2}\%$ interest, and assume first annual payment of amortization at the beginning of the year, the first amount payable toward this million dollars of "present value" would be \$4,051 and the thirtieth and last annual payment to be made at the beginning of the thirtieth year would be \$121,534.

Now I have checked this schedule and find it to be correct mathematically but this still leaves room for one to say that it is quite a unique schedule whereby the escalation of annual payments is of this order and where the terminal period taxpayers are left to meet the highest sector of the annual amounts. Indeed, one may gain an appreciation of the so-called uniqueness by noting that if we were to pay "interest only" at $3\frac{1}{2}\%$ on one million dollars right from the start, this particular schedule requires a period of nine years before its own amortization payouts come to as much as what we would have been paying as "interest only" each year from the very start. I fear that an accumulation of liberalizing amendments could cause a compound snowballing effect whereby the later payments of the composite schedules would be quite onerous on those meeting same. While

I am in favor of almost any method which will serve to improve the financial structure of the CSR Act, I am a bit leary about the particular effect of this sort of schedule for possible big buildups in disbursements later on.

K. THE THIRD PROPOSED FUNDING PRONG, VIZ, "PEGGING"

Here, again, the third prong of the proposed new method of funding filters down from the Cabinet Committee's Report. For instance, on p. 20 of said report, in the 2nd full paragraph we have partial descriptions of this arrangement including taking care of the CPI amounts. For funding purposes (or, if more accurate, for appropriation purposes) the size of the fund must be watched carefully and direct appropriations paid when necessary to peg said fund at its prior top level or at an amount equal to "employee equity" if greater. Now, "employee equity" has been defined, and there is no mystery about "maximum size of the fund"; and yet there does remain an unresolved matter concerning the proper alimentation of the fund; this is in the interplay of "employee equity" and "maximum fund". For instance, suppose we have 100 individuals to deal with in a particular type of determination; suppose Mr. A. has a top fund of X dollars and an employee equity of Y dollars; then suppose these corresponding figures for Mr. B are W dollars and V dollars; for Mr. C. U dollars and T dollars, respectively; and keep on going up the list of names. Now it might very well turn out that the grand total of the fund exceeds that of the employee equity; it may very well be that in that situation, each top fund exceeds each amount of equity; and it may be OK and no problem. But suppose that when you have finished with one group of participants, you recalled that some of them had had a maximum fund in excess of equity, while some had had the reverse. What did you do? Did you pick the lower of the two each time or did you determine that one of the entities was going to exceed the other for sure and so thereby you reasoned that you should always pick the category having the same character as the winning total? It seems to me that there might well be spots where, for some people, the choices would be made in one pattern while for other people the choices would be made in another and that the final answer would depend upon the choices under these patterns. If there is a material point in my example, I feel it should be clarified in the Bill as to just how the comparison of the amounts is to be carried out.

Mr. BRONSON. Part A gives my background, and all I say is that I am a member of a number of actuarial organizations, some by examination and some not; some international, some national; and that I have served on the Commission's Board of Actuaries since the last vacancy, which occurred in April 1962.

I have an extended dossier, as I say, but if this is sufficient background, let it stand.

In part B, I point out that I am not speaking for the Board of Actuaries. I prepared my statement with the thought that I would try to clear it with the other two members before I came this morning, and I say in here—because I felt I would be able to do it—that I have done so by long-distance telephone.

The record should show an amendment to that since the last commas, you might say, and periods were made late last night, it was impossible to contact these two gentlemen, one who is in Florida, and another in travel work, and I don't know quite where he is at the moment.

Mr. DANIELS. For the record, Mr. Bronson, how many members compose the Board of Actuaries?

Mr. BRONSON. Three

Mr. DANIELS. And who are the other two members besides yourself?

Mr. BRONSON. The other two members are George B. Buck—and you may be interested—in fact, it is uniquely a historical matter—that his

father before him was for many years a member of this same Board of Actuaries.

And the second member is Russell R. Reagh, who was a well-known public servant in the Treasury Department for a great many years, and took an interest, constantly, in this act; furthermore, in the Treasury, Mr. Reagh and Mr. Brown, who sits here beside me, were colleagues in their public services with the Treasury Department.

Mr. DANIELS. The statement you have presented here this morning contains your views, and it has not received the approval of the other two members?

Mr. BRONSON. That is correct.

Mr. DANIELS. Suppose you get into the substance of your remarks with reference to the bill.

Mr. BRONSON. I am going to read the next paragraph, which is a capsule sketch of the bill, according to my understanding:

To improve the long deterioration in funding for the Civil Service Retirement Act, H.R. 10912, of June 15, 1967, has been developed by the Civil Service Commission utilizing portions of the Cabinet Committee's Report to the President of February 15, 1966.

And then Mr. Macy gave certain descriptions—I have an elision here—gave certain descriptions thereof, which I won't repeat. But the net effect is that the action proposed comprises a triple set of funding devices, each quite different, actuarially, from the other. Just to identify them, by my interpretation, the first is to assure the meeting of "normal cost" as defined in the bill—it doesn't say "in the bill" here, but it is defined in the bill—by matched employee-agency contributions.

The second prong, as I call them, is in planning to meet the costs for new unfunded liability through an increasing 30-year schedule written into the bill for amortizing said liability.

And the third prong has filtered down from the Cabinet committee's report, which included taking care of the CPI amounts. Under this method the size of the unfunded liability must be carefully watched and compared with the total "employee equity," as defined in the bill; then the greater of these two amounts would establish the figure which should aliment or "peg" the overall amount on hand, which amount, having been bolstered up, would thereby automatically prevent any increase in the unfunded liability.

My last statement comprises a description of the three proposed prongs, as I call them, for bolstering the financing of the system.

Paragraph D, "My Statement's Content." This paragraph outlines certain of my testimony which explores the purpose and envisioned operation of my understanding of the bill, via my questions, mathematical illustrations, commentary, constructive proposals, et cetera. I shall strive for brevity. To that end, and from my first draft, I eliminate or shorten portions which Mr. Macy preceding me will have covered adequately, and I accomplished some of that shortening last night in the final going-over.

Indeed, the caveat for me to observe is that of keeping within the boundaries of actuarial science and not to go into matter extraneous thereto.

I see myself as an actuary and as expert in no other area.

Paragraph E, "A few lesser points." Skipping the first little paragraph there, let me read (i).

On page 2 of the bill, in definition (19), line 10, I would suggest for accuracy and full clarity that the word "future" be inserted before the word "benefits." This definition involves the concept of "present value" which can encompass and evaluate both payments of the past and those ahead. Indeed, in lines 10 and 11, reference is made to benefits payable to former employees, which would be payments of the past which you could obtain a present value of by appropriate computations.

While it is doubtful that anyone would mistake the "forward view" intended in (19), this inserted word would clinch it. As allied to my point, note in line 15 that the sole use of the word "future" puts a "fix" on the intention. That is just a trivial suggestion for improving the language of the bill.

Second—I am reading from page 3—on the same page 2, same (19), in line 11—and this is most trivial, I believe—the first letter of "members" should be capitalized, "members being those who are covered as Congressional Members under the act." I think that is usual all the way through, is it not, Mr. Brown?

Mr. BROWN. Yes, sir.

Mr. BRONSON. But here it got missed.

Third, on the same page 2, on the last line within definition (20), natural questions concern whether "lump sum credits" and "voluntary contribution accounts" have been defined in the basic act. I found that the former was very clearly defined there, but not the latter.

Now, these terms, "lump sum credits" and "voluntary contribution accounts," are important; they have an important function in this bill. It turns out that though not in the definitions of the basic act, there is in section 12 thereof a description of—not a definition, but a description—of the term "voluntary contribution accounts" that is so adequately complete as to constitute a definition or better. Hence I feel that those two terms are adequately clarified as they stand now.

Taking up certain more substantial points it is important to note that the employee contributions generating "lump sum credits" accrued interest at a 4 percent rate to December 31, 1947, and then 3 percent to December 31, 1956. After that no increase has been granted to employee money in the fund, except that, in contrast, the voluntary contribution accounts have enjoyed 3 percent compound interest all the way, which basis is still being maintained on said accounts.

Fourth, under either form of post-retirement settlement, that is, with terminated 4 percent/3 percent interest or the "voluntary" 3 percent basis, whichever is applicable, interest treatment should conform as between principal and annuity payments. Now, Mr. Brown can probably, undoubtedly, advise—I couldn't tell myself—whether there is that post-retirement interest granted on these items and if so, does it conform between the two bases?

Mr. BROWN. There is not. Interest ceases at date of separation.

Mr. BRONSON. Interest ceases at date of separation and hence there is no interest computed on the annuity for the reduction purpose?

Mr. BROWN. That is correct.

Mr. BRONSON. That was my question, which I couldn't tell, but it was one which had substance as a technical matter.

Coming to paragraph F, headed "normal cost," there are four pertinent points to mention for this term when used in regular parlance and not as a bizarre entity.

Mr. DANIELS. Can you highlight those four points?

Mr. BRONSON. Probably there are more than four. If you will permit me, I will read the next two paragraphs, which contain all—

Mr. DANIELS. I don't think it would be necessary to read the statement verbatim. Of course, the Chair and members of the committee are competent to do that. I think what you should do is summarize the major points that you are trying to make here on normal cost.

Mr. BRONSON. Well first off, it was very odd to me in discovering—by searching the matter, that the Civil Service Retirement Act, ever since 1920, has carried what now amounts to 28 definitions of terms. There were probably not that many at the start. But nowhere in those 28 is "normal cost" one of the defined terms. It struck me as extremely odd because of the importance of the term "normal cost" and its usage in the act.

Then the Board of Actuaries had to go ahead and make a definition of their own because they were directed by the act to make a report which involved "normal cost."

Mr. DANIELS. Mr. Bronson, did you see the statement made by Chairman Macy of the Civil Service Commission—

Mr. BRONSON. Yes, sir, I read it—

Mr. DANIELS (continuing). Which was presented to this committee yesterday?

Mr. BRONSON (continuing). Hurriedly this morning.

Mr. DANIELS. He gives a definition of "normal cost" at page 2. He states that "normal cost" is that level percentage of annual pay which, invested at interest, is required to cover the cost of benefits earned each year, starting with cost for each employee at the time he is appointed.

Mr. BRONSON. Yes, sir. That would satisfy Mr. Macy. That has the elements of a "normal cost" concept in it, and yet I could dig up for you 20 different definitions of "normal cost" and there is no standardization to that term. And that is one of my difficulties here, that we ought to know what actuarial elements are involved in any term for normal cost.

Mr. DANIELS. Do you think the definition given by Mr. Macy of what the term "normal cost" means is a proper and a sound definition? Or do you wish to disagree with it?

Mr. BRONSON. I think it is proper and sound, depending upon how he then goes on to use it in the funding method for the plan. I can make up another definition which is used differently in the funding method which stands up also, and so on and so on. And Dr. McGill's Commission on Terminology up at Wharton School has such fluidity in it, when it comes to defining "normal cost," that any funding mechanism almost—

Mr. DANIELS. Well, for the purpose of what we have under consideration here, how would you define "normal cost"?

Mr. BRONSON. Well, now, that is a pretty big question to fire at me sitting here.

Mr. DANIELS. You came here to testify as an expert, and we would like to have the benefit of your expert views.

Mr. BRONSON. I would like to, afterwards or something, sit down here and write one out that I felt was—

Mr. DANIELS. Well, if you are not prepared to give a definition at the present time, you are at liberty, and the Chair will grant you leave

to submit a definition as to what you believe the meaning of the term "normal cost" should be for the purpose of this act.

Mr. BRONSON. I would be glad to study that matter and try to do so. It is one of those nettles that you pick up and you get pricked because one thing depends on another here. And if you do not have the funding mechanism that is intended, known completely and precisely, your definition of "normal cost" or any other term may have flaws in it.

Now, I would be very glad, sir, to study this question and submit one that I felt would be suitable for the act, or possibly to qualify it. I just don't say now you have got one in the bill, and this is a very important matter, and this is almost the whole reason why I have got this section on "normal cost" in here, because I would like to see a definition of "normal cost" assured to be in the bill according to the way the Commission has in mind in running this scheme of funding from now on out, so that nobody could pick holes in the thing. It would stand up actuarially and legally and literally, and produce the sort of answer that is in mind down the road for "normal cost," the future of the "normal cost" in the three-pronged approach that Mr. Macy outlined yesterday, but I am not satisfied at all with the present situation in that regard. I think it is fuzzy. I don't know when one type of benefit increase is admitted into new "normal cost" and when it is denied from such admission.

Mr. DANIELS. Mr. Bronson, in reading through your statement, I come to the schedule section, to which Mr. Macy testified, the 30-year amortization schedule. You make this statement on page 10:

I fear that an accumulation of liberalizing amendments could cause a compound snowballing effect whereby the later payments of the composite schedules would be quite onerous on those meeting same. While I am in favor of almost any method which will serve to improve the financial structure of the Civil Service Retirement Act, I am a bit leery about the particular effect of this sort of schedule for possible big buildups in disbursements later on.

I would like to direct your attention to those two sentences and ask you to comment about that. Apparently you are opposed to the small payments in the beginning of the 30-year term and progressively increasing as the years roll on, so that the largest payments are made at the end of the 30-year period.

Now, do you disagree with Mr. Macy in that regard?

Mr. BRONSON. I have grave doubts about the workability and the satisfaction that would come from that. I don't say I am opposed exactly, because as I said, I am in favor of anything that will do some good here. But when you have a synthetic schedule of amortization payments—and that is all this is—it is an arithmetical progression. You could have made a geometrical progression or any other progression, but this happens to be arithmetical, but it is unique. In my experience I have never seen one like it, and I note the buildup, and I point out in here somewhere how its uniqueness is attested to by the fact that it takes 8 or 10 years before the amortization payment amounts to as much as interest only on the \$1 million unfunded liability. And now, almost everybody knows that something called normal cost plus interest only is sort of a minimal type of funding arrangement, and if it takes 8 or 10 years before you get up to interest only, it makes it a unique schedule. I mean, that is one of the things that it does.

Mr. DANIELS. Well, what is your opinion, then, on this schedule? I have a copy of it before me, if you would like to see it.

Mr. BRONSON. No, I have the bill. Thank you.

Mr. DANIELS. And I would like to have your comment with respect to whether you approve or disapprove. Do you think it is sound or unsound? And if you deem it unsound or unworkable, what do you recommend?

Mr. BRONSON. Well, I am inclined to feel that it is dangerous in that it will result in a breakdown—now, I perhaps shouldn't try to read the crystal ball of what Congress is going to do, but I fear that it could well result in a breakdown of congressional following of this highly rising schedule, especially if it is piled the one on another on another for numerous successive amendments, which is something we have had. I have got a book full of amendments to this act. And hence I feel that it is a very doubtful schedule as one which will carry through to do the job intended.

It is all right in theory. The objective is fine, but I feel the practicability is quite weak.

Mr. DANIELS. What would you recommend in lieu of this schedule? Would you have fixed, constant payments for over a period of years? Or would you eliminate the schedule entirely? And what would you recommend in lieu thereof?

Mr. BRONSON. You could have normal cost properly described, plus interest payments, on the unfunded deficiencies. That is one thing.

You could have a full-scale 30-year amortization.

If you want a 30-year schedule, make it right up from whole cloth, not some synthetic arithmetical progression.

Mr. DANIELS. Chairman Macy testified that that would not be practical or good business, inasmuch as you would be collecting a large sum of money in this fund which would be unused for a number of years. The benefits would not be payable until some future date, and consequently it would not be wise to accumulate this vast sum of money which would not be payable until many years in the future.

Mr. BRONSON. It strikes me that the Government is always borrowing money, and that if it doesn't borrow it from Peter, it borrows it from Paul. And if it got it here, it wouldn't have to get it somewhere else. And so that I am not—with all deference to Mr. Macy—I am not too impressed by that argument.

Mr. DANIELS. Well, then, you recommend to this committee that the payment should be a sum equal to the normal cost plus interest?

Mr. BRONSON. As a minimum.

Mr. DANIELS. Payable when? Immediately?

Mr. BRONSON. The interest, you mean?

Mr. DANIELS. No, when would you deposit this money in the fund?

Mr. BRONSON. Oh. Annually. You pay the normal cost—

Mr. DANIELS. As promptly as the liability accrues?

Mr. BRONSON. You pay the normal cost. If the agencies and employees are meeting it, they can. I suppose it comes in monthly through their paychecks, or however it is gotten in.

Mr. DANIELS. Well, we are talking about this particular situation. As you know, the unfunded liability, as testified to, amounts to the sum of \$49,100 million as of June 30, 1966. What would you do? Or what do you recommend with respect to the unfunded liability?

Mr. BRONSON. The program we just mentioned would pay interest on the \$49 billion plus the normal cost and thereby—with the intention that that would prevent further growth in the \$49 billion.

Mr. DANIELS. Well, Chairman Macy thought that we could let that unfunded liability stand as it is and not do anything about it at all. Now, do you disagree with that view?

Mr. BRONSON. No, indeed. That is exactly what I am saying.

Mr. DANIELS. All right. Now let's get to point 3 of Mr. Macy's testimony with respect to "pegging."

Do you have any comment on that—"pegging" the fund?

Mr. BRONSON. I have in here. It will be found that I do have some questions about the "pegging" procedure.

I think there again it is not sufficiently clarified in the act, because you peg to the amount of the fund of the previous year, or to employee equity, whichever is greater.

Now, assuming there are no difficulties in determining employee equity—and I guess there are none—but one would think the Commission would have to go through seriatim and test these employee equities against the proper proportion of the previous year's fund to see which is which.

Now, if you go through and you total up in the aggregate, wholesale, and come out with an obvious answer that the fund pegging is bigger than the equity pegging, you may not be pegging at equity for certain people. Mr. A may have a fund which exceeds his equity. Mr. B may have a fund which is below his equity.

To how much exactness have they in mind? Are they going to test all the people as to which is the greater of the two, and then take the greater? Or are they going to do it wholesale?

That is the matter that is not clear in the bill.

Mr. DANIELS. Well, from an actuarial point of view, what would you recommend—that the fund be pegged? And what would you give as the meaning of the term "pegging"? Would you define it to mean the employee's equity; that is, the amount of contributions that he has made over the years to the fund?

Mr. BRONSON. If that has a psychological help, and it may, that a person can say, well, at least our money is being taken care of—the pegging of employee equity in name at least may be well worthwhile. But I certainly would recommend for an administrative device something other than testing 3 million different accounts as to whether last year's fund exceeded their employee equity or not, and taking the greater of the two. I would do it by some wholesale procedure.

Now, perhaps this has all been thought through, and Mr. Brown might throw a vast light on this matter. I just don't know. I haven't talked to him. But that is one of the technical actuarial points—it seemed to me it was my function to think about.

Mr. DANIELS. Mr. Brown, do you have any comment on that?

Mr. BROWN. I would like—I am confused on Mr. Bronson's distinction between the fund of an individual and that same individual's equity. I wasn't aware of any difference.

What do you have in mind by his fund?

Mr. BRONSON. Well, it seems to me you could have a reserve, an actuarial reserve, for his annuity, his prospective annuity, which exceeded his accumulated contribution plus interest, certainly you have got the Government money in there, and I was viewing it, the fund, as the amount which stood in the total assets on hand to the utmost

extent, that it could stand from the reserve, and it might well exceed the employee equity.

Suppose you were semifunded, full reserve, and you would have more than the employee equity, and that would be what I thought as his fund.

Mr. DANIELS. How much more?

Mr. BRONSON. Well, one can't tell without knowing the employee's contribution history and the interest added to it that stands to his credit, and then you test that against the reserve value that has been built up, which could include some Government funds.

Mr. DANIELS. Well, now, the Board of Actuaries reviews these accounts each year. And you have presumably done this year after year. You should have some knowledge of the amount they contribute. Now in your judgment, what would you say would be a safe, a fair, and reasonable amount of money over and above their actual contributions that you deem necessary to guarantee the security of the fund?

Mr. BRONSON. Well, if their contributions—you see, interest stopped on their contributions back in 1955, and hence what stands as their equity, according to my understanding, is less than would stand there in a normal reserve fund in respect of employee money that had been put in and accumulated at interest.

But if we ignore that fact of the hiatus since 1955 of any interest accruals on that, you might have an outside reserve fund—I don't know, I am just guessing out of thin air—of, let's see, this is matched contributions—and the Government money ought to accumulate faster than the employee money because no death benefits has to be paid. So you might have a reserve equal to three times the employee equity, or $2\frac{1}{2}$ times, or something like that, if it were a full reserve. But it isn't a full reserve. We know that, because there is \$48 billion that hasn't been accounted for.

But it still could be over and above an employee equity summation.

Mr. BROWN. Mr. Chairman, may I say something at this point?

Mr. DANIELS. Surely.

Mr. BROWN. We at least intended that the bill would be quite clear in respect to this pegging provision, in that it would hinge on what we thought were two clearly defined terms. You would invoke this pegging arrangement if the fund balance fell below any prior level. And "fund balance" is defined in the bill as meaning the investments of the fund plus any cash.

I believe Mr. Bronson has read into the term "fund" something that certainly was not intended. And if it is not clear, then we would certainly want to sharpen the language. But there was no intent here that "fund" should encompass the reserve concept which Mr. Bronson has been defining as being the value, if I may say, of the employee's future benefit rights.

The other term that would be invoked in the pegging arrangement is the employee equity, which again is defined in your bill. So I don't believe we get into this reserve problem which Mr. Bronson has been discussing. At least, we had no intention to do so.

Mr. BRONSON. Beyond that you still have my question about the foolishness of getting into refined administrative methods. You have got an aggregate method.

Mr. DANIELS. I want to present this question to you. Inasmuch as the full faith and credit of the United States backs the fund, do you deem it necessary to enter into any financing of it? Do you think we should provide for improved financing?

Mr. BRONSON. I would answer that, sir, by perhaps being an oddball in saying that I feel there is—well, like George Orwell in “1984,” everybody is equal but some are more equal than others. I feel that this full credit and faith of the United States is absolutely true, and we used it time and again in social security work, and yet I wonder if a series of catastrophes or circumstances might not arise whereby certain things would take precedence as to their being paid for by the U.S. Government over other things, should some great catastrophe strike. And perhaps there might be a taxpayers’—not rebellion—but delay or something in wanting to meet these benefits as against something that had occurred from getting hit by a rocket and requiring absolutely urgent need. And I feel that from the employee personnel relations standpoint that a fund in hand, to show and give annual reports on and so on, is well worth the price of setting that fund up.

Mr. DANIELS. You think it is good business, then, to have a fund?

Mr. BRONSON. Yes, sir. Let me say this—the President’s Committee on Private Retirement Plans, sometimes called the Cabinet Committee just like this thing was, this Federal personnel one was—issued, I believe in January 1965—has raised a great many questions of examination in the private pension area. And one of them is the sufficiency of the funding of private plans, and that was pointed up particularly when trouble struck the *Studebaker* case, although there have been many cases before that one.

Anyway, that committee came up with recommendations that private pension plans, in order to receive tax deductability for their plan as a qualified plan, should at least come up to a given standard, which was a 30-year amortization plus the payment of normal cost. And many folks in private industry felt that this was an infringement of their privacy, let’s say, or of private plans, but nevertheless that was what was talked about. But one of the arguments that you heard around quite frequently was, well, for heaven’s sake, here they are making us meet some standards of funding, and their own civil service plan is \$48 billion in the hole and going down faster all the time.

Now, why this different attitude? I think you have a psychological edge, definitely, by a certain fairly good funding degree.

Mr. DANIELS. Mr. Brown, do you care to add anything further to what Mr. Bronson has said?

Mr. BROWN. No, sir; I have nothing more to add.

Mr. BRONSON. Could I say one word?

Mr. DANIELS. Surely.

Mr. BRONSON. I trust that the table on page 9 will be observed, because it brings out in columns 2 and 5 the point I made, that there is a considerable difference from one period to another in the normal cost setup.

Mr. DANIELS. Yes, we will take that into consideration in studying this testimony, Mr. Bronson.

I want to thank both of you gentlemen for coming here this morning and letting this committee have the benefit of your views, which the

subcommittee will take into consideration in its study of the legislation before us.

The subcommittee will stand adjourned until 10 a.m. next Tuesday, November 14, at which time the witness scheduled to appear before the subcommittee is Mr. Charles Schultze, Director of the Bureau of the Budget.

(Whereupon, at 11:30 a.m., the subcommittee was adjourned, to reconvene at 10 a.m., Tuesday, November 14, 1967.)

(A supplemental statement, submitted by Mr. Bronson, is as follows:)

SUPPLEMENTAL STATEMENT OF DORRANCE C. BRONSON, F.S.A.

Following my presentation on November 9, a further study of the bill's definitions convinced me that I had misinterpreted certain language. Hence, the following should be substituted for that in the prepared statement beginning with the third phase of the last sentence of paragraph C:

"and the third, called 'pegging', aims at having the Treasury, as a government contribution, if needed for any year, bolster the fund balance (as defined in (18) of the bill) so that said balance would amount to as much as the larger of (i) the previous year's fund balance, or (ii) the amount of employee equity (as defined in (20) of the bill) for the current year."

In Sec. K of the prepared statement (pp. 10 & 11), my same mistake invalidates usage of concept of *individual* "fund balances" or "employee equities" for comparative purposes; instead, use of collective aggregates would seem to be accomplished, except for below, by ending Sec. K with 2nd sentence on p. 10.

In spite of having revised Sec. C, p. 2, I feel it preferable—so long as this note of explanation "is along"—to let stand the original Sec. K. My reason lies in the fact that a constructive sermon may be found in my usage of the incorrect elements as now contained in Sec. K. This sort of sermon should stand as good warning for one's initial data and assumptions to be well tested are proceeding too far. For example, under various types of comparison of two entities, it is not at all unusual or illogical to interpret the criterion for the job assigned as comprehending individual *seriatim* comparisons and not to follow comparisons of totals or of categorical groupings.

I trust this accompanying caveat, *Nota Bene*, will, in fact, serve some useful purpose.

RETIREMENT FINANCING

TUESDAY, NOVEMBER 14, 1967

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON RETIREMENT, INSURANCE, AND HEALTH BENEFITS OF THE COMMITTEE ON POST OFFICE AND CIVIL SERVICE,

Washington, D.C.

The subcommittee met at 10 a.m. in room 210, Cannon House Office Building, Hon. Dominick V. Daniels (chairman of the subcommittee) presiding.

Mr. DANIELS. The Subcommittee on Retirement, Insurance, and Health Benefits, in continuing its consideration of proposals to improve the financing and funding practices of the civil service retirement system, has scheduled as its witness this morning the Director of the Bureau of the Budget, Mr. Charles L. Schultze.

Last minute developments, however, have precluded Mr. Schultze's appearance.

In his absence, the subcommittee is pleased to welcome the Deputy Director of the Bureau of the Budget, Mr. Phillip S. Hughes.

Mr. Hughes is accompanied by Mr. David McAfee.

Gentlemen, we do appreciate your appearing here this morning to furnish the Bureau views on this most important subject. I will ask you to step over to the witness table.

STATEMENT OF PHILLIP S. HUGHES, DEPUTY DIRECTOR, BUREAU OF THE BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT, ACCOMPANIED BY DAVID McAFEE, MANAGEMENT ANALYST

Mr. HUGHES. Thank you very much, Mr. Chairman.

Mr. DANIELS. You may proceed, Mr. Hughes.

Mr. HUGHES. We do appreciate the opportunity to appear before you and express our views on this legislation in which we are very much interested and very much concerned with.

With respect to my appearance for the Director, Mr. Schultze, I would like to extend his apologies and simply point out that up until late last night he had planned to be here himself. The statement that I will give is the statement that he would have given. It was drafted substantially by Mr. Schultze.

I do not very often have that good a ghostwriter, Mr. Chairman, so I am particularly pleased to be here on his behalf and in behalf of the Bureau.

Mr. DANIELS. You are presenting his views and not your own so you cannot get into trouble with the boss.

Mr. HUGHES. I think we are pretty well in agreement on this, Mr. Chairman. I will try and defend our mutual honor.

Mr. DANIELS. You may proceed.

Mr. HUGHES. Mr. Chairman and members of the subcommittee, Chairman Macy has described in detail the features of the Cabinet Committee proposal for financing the civil service retirement system.

I would like to discuss the budgetary and overall financial aspects of the proposal.

It is useful, in considering the financial aspects of the civil service retirement system, to think of it in three parts:

First, current service liabilities. Each year's service by each Federal employee adds to the future benefits which the retirement system must eventually pay out. Since the employee only contributes part of these benefits through a payroll deduction, the remainder must be paid by the Federal Government.

Each man-year of Federal employment, therefore, has a retirement cost attached to it which is just as truly an employment cost as the wages and salaries currently paid out. To the extent that the sum of the Federal and employee current contribution rate covers actuarial costs, the retirement benefits covered by each current man-year of employment "pay for themselves" and add nothing to the unfunded liability of the retirement fund.

Second, the potential increase in unfunded liability for past service, caused by pay raises and liberalizations of retirement benefits. Every time a Federal pay raise is enacted, the retirement value, and the cost, of the past service of Federal employees is increased. After a pay raise, all the past years of service will be multiplied against a new and increased "high 5" in determining retirement benefits. Automatically, the cost to the Federal Government of future retirement payments increases, and none of the increase is covered by employee contributions. Similarly, when benefit liberalizations are enacted, or current annuitants given a benefit increase, or new groups blanketed into the retirement system, the value of future retirement payments increases. Unlike the first category—currently accruing liabilities—these costs are not related to the current level of employment, but simply reflect the impact of pay raises or benefit liberalizations on past service.

Third, the unfunded liability which now exists because the civil service retirement system was not adequately funded in past years. Even if the Federal and employee contribution rates were sufficient to cover fully the currently accruing liabilities, and even if appropriations were made to cover the increase in unfunded liabilities due to future pay raises or benefit liberalizations, the retirement system would still have a large and growing unfunded liability. This arises from the fact that in prior years the retirement system was not funded to cover its full actuarial costs. And since the fund is far below the full actuarial level, it forgoes interest payments each year which add still further to the actuarial deficit. At the present time, the actuarially computed unfunded liability is over \$48 billion.

These, then, are the three major financing aspects of the retirement fund:

Current service liabilities, arising, each year, from the actual number and grade level of Federal employees;

Potential future increases in unfunded liability, arising from the impact of pay raises or benefit liberalizations on accumulated past service;

The present unfunded liability of the system, arising from failure in past years to cover the full actuarial costs of the retirement system.

Each of these aspects of the civil service retirement system is covered by the Cabinet Committee's financing recommendations, in the light of sound budgetary and financial principles.

In the first place, it is essential to good budgeting that each Federal program be judged and evaluated in the light of its full costs. In assessing the costs and benefits of a Federal education program, or a farm loan program, or an urban housing program, the full costs of the Federal manpower used in administering the program should be included in the calculation. Each man-year of civil service employment represents a cost to the Federal Government, not only in terms of direct wages and salaries, but also in terms of what that man-year of employment adds to the cost of the retirement system. Federal agency contributions, together with employee contributions, should therefore cover the full amount of what each current year's service by a Federal employee adds to retirement costs.

At the present time, the normal cost of each year's service by a Federal employee amounts to 13.86 percent of his salary. The combined agency-employee contribution amounts to 13 percent, almost a full percentage point lower than full-cost coverage would require. Further changes in the retirement system recommended by the Cabinet Committee would raise normal cost to 14.5 percent. About 0.5 percent of that would be caused by features designed to improve management. As a consequence, the Cabinet Committee recommended a contribution rate of 7.5 percent for Federal agencies and 7 percent for employees. Thereafter, the Cabinet Committee's recommendation provided for automatic adjustment by administrative—Presidential or Civil Service Commission—action, with no requirement for specific statutory action by the Congress.

Requiring employees to share the normal cost on an equal basis does not mean that employees are paying half the cost of the retirement system. Continuing improvements in salary rates and benefit liberalizations have increased—and undoubtedly will continue to increase—the retirement value of past service, whose cost the Federal Government bears fully.

The principle of full-cost coverage for currently accruing service liabilities is not so much a matter of financing, but of full-cost disclosure. We ought to know what the full costs of any Federal program are. Even if the entire Federal retirement system were on a "pay as you go" basis, principles of good budgeting would require that in making evaluations of Federal programs we "impute" a retirement cost to each Federal employee hired.

The next important aspect of retirement system funding relates to increases in past service liabilities. Such increases occur whenever Federal salaries are raised or retirement benefits are liberalized. Here again, full-cost disclosure is important. When the Executive considers, for transmission to Congress, and when the Congress itself considers

pay increase or benefit liberalization legislation, these considerations should be based on a full awareness of the future costs to the taxpayer of the increased retirement payment which will result from the proposed actions. Every pay raise and benefit liberalization has a price tag for increased retirement payments on past service. Those additional payments will be a cost to the taxpayer. The price tag should be known and action taken to meet it each time legislation is proposed and enacted.

The Cabinet Committee's recommendations make provision for handling this situation. The Committee recommended that every future action which raises the unfunded liability of the retirement system be accompanied by an explicit authorization to make appropriations to the retirement fund to cover the increase in retirement benefits based on past service. The authorization would provide for a gradually increasing stream of appropriations, spread over 30 years, and calculated, in total, to equal the addition to unfunded liability. The pattern of appropriations rises gradually over the 30 years rather than being an equal amount each year. That pattern was designed to match, on a rough basis, the actual outflow of increased benefits. In other words, the appropriation payments into the fund are roughly scheduled to coincide with the outflow from the fund, rather than to build up a surplus in the early years to be paid out later.

The third aspect of civil service retirement financing relates to the unfunded liability which has already been incurred by failure to provide full-cost financing in prior years. It is a widely held view that the "sanctity" of the Federal Government's obligation to pay retirement benefits to its employees requires that the civil service retirement system be funded with a large surplus. In lieu of full funding, proposals have been made to appropriate into the retirement fund each year an amount equal to the interest which the system is "losing" because it is not fully funded in terms of complete actuarial costs. Payment into the fund of interest on the unfunded liability would build up a very large surplus over the next 30 years.

I believe that these arguments, however sincerely held, are based on false analogy between private and Federal Government retirement funds. The Federal Government, through legislation, has entered into a solemn contract with its employees to pay them retirement benefits according to a stipulated formula. Why does anyone believe that the only way this solemn obligation can be guaranteed is through the appropriation of large sums into the retirement fund—in advance of need—which will be used to purchase Government bonds whose interest will, in turn, be the source of retirement benefit payments? Government bonds are nothing more or less than a promise to pay bondholders principal and interest. Is the sanctity of the Government's promise to its employees a less solemn obligation than its promise to bondholders? If the Government can't be trusted to meet its contractual obligation to its employees, will the substitution of another promise—in the form of a Government bond—be any more secure? Indeed, it is somewhat degrading for both the Government of the United States and its employees, to suggest that, as bondholders, employees could rely on Uncle Sam's contracts, but as employees they cannot.

In short, I see no need to appropriate a large fund of Government bonds into the civil service retirement system in order to insure the

sanctity of the Federal Government's contractual obligations to its employees. This merely substitutes one kind of promise for another. For this reason, the Cabinet Committee's recommendations do not provide for building up a larger surplus in the retirement fund, simply as a means of covering part or all of the unfunded liability which has arisen in past years. This is also why the amortization schedule, which the Cabinet Committee recommended for appropriations to cover the retirement cost of future legislation, has a pattern of gradually rising amounts. The schedule is designed to provide funds to cover increased benefits as they occur, not to build up an unneeded surplus in the fund.

The committee has indeed recommended that the civil service retirement fund not be allowed to decline. Its recommendations provide, as Chairman Macy has spelled out, for permanent indefinite appropriations as necessary to keep the fund from declining below the highest year-end balance which it reaches, or below "employee equity," whichever is greater. Employee equity is the total amount of retirement contributions made by, and still remaining to the credit of, employees and former employees.

We made this proposal for two reasons. In the first place, convenience and safety dictate that there be an amount in the fund equal to several years' benefit payments. This would provide the fund with a reasonable margin of "working capital." Second, despite our own strong belief that the Federal Government's "promise to pay" is indeed ironclad, a situation in which the balance in the fund began to fall, or was reduced below employee equity, might have an undesirable psychological impact, in the light of widely held views about the integrity of the fund. The Cabinet Committee's recommendations would take care of these factors. The fund would never decline, it would never fall below employee equity, and it would always have a very safe margin of working capital equal to about 3 years of benefit payments.

In summary, Mr. Chairman, the problem of "sound financing" for the civil service retirement fund is not a problem of providing the same "full actuarial" funding as might be appropriate with private retirement systems. The Federal Government's promise to pay retirement benefits to its employees is an ironclad obligation, whose soundness cannot be improved by substituting a promise to pay bondholders. From the viewpoint solely of sanctity of obligations, a Federal pay-as-you-go system is equally as safe as a fully funded system. The integrity of the system is not at issue.

The real problem of civil service financing is primarily one of budgetary and legislative responsibility. Responsible procedures require that the full retirement system costs involved in Federal program and legislative actions be fully disclosed and the necessary steps be taken to cover those costs when program and legislative decisions are made.

It is to meet this objective of budgetary and legislative responsibility that the Cabinet Committee's recommendations provide—

First, for contribution rates in each agency sufficient, in combination with employee contributions, to cover the full retirement costs of the agency's current man-years of employment; and

Second, for future retirement and pay legislation to be accompanied by statutory authorization to appropriate funds sufficient to cover the added costs associated with past service.

In considering the financing of the civil service retirement system, I believe it is essential that the distinction I have made be kept in mind. As far as the Federal Government is concerned, so-called actuarially sound financing proposals designed to provide enough Government bonds to "guarantee" the integrity of the Government's promise to pay are a snare and a delusion. On the other hand, financing proposals designed to cover the full retirement cost of current employment actions, and to disclose the full cost of future pay and retirement legislation are an essential component of sound budgetary and legislative procedures. It is toward this end that the Cabinet Committee recommendations are directed.

Mr. DANIELS. Thank you, Mr. Hughes, for a very fine statement. You covered the subject matter very, very well.

Having listened to Chairman Macy of the Civil Service Commission last week with respect to the contributions to be expected from the employee and from the Government, he mentioned a figure of 13.86 percent of the Federal employee's salary as an amount sufficient to cover the normal cost—to be contributed one-half by the employee and one-half by the Government. That would amount to approximately 7 percent by each.

Mr. HUGHES. That is right.

Mr. DANIELS. On page 4 of your statement you increase the amount of the cost to 14.5 percent. The additional amount of seven-tenths of 1 percent is due to improved management.

Will you please explain that feature?

Mr. HUGHES. Yes, Mr. Chairman. The figures that I used on page 4 of my statement referred to the recommendation of the Cabinet committee. The 13.86 percent to which you refer is the present normal cost of the system.

The 14.5 percent would reflect the normal cost of the system as revised to include several amendments and liberalizations which the Cabinet committee proposed. These liberalizations account for the extra six- to seven-tenths of a percent above 13.86.

The 14½ percent combined contribution, 7½ percent Government and 7 percent employee, would be contingent upon the enactment of these benefit liberalizations.

Mr. DANIELS. What are those liberalizations?

Mr. HUGHES. There are several of them. I think the largest single component of the package would be to provide a social security minimum benefit based on existing social security levels.

A second component, relatively small, was a disability requirement-sick leave adjustment. There were certain deposits and redeposits which are at a minimum level; a selective retention at age 65; and then a survivor minimum benefit. But the biggest single item, amounting to 1.85 percent of payroll, was the social security minimum.

Mr. DANIELS. This committee did conduct hearings on transfer of credits to the Social Security Administration. The House Ways and Means Committee also held hearings, but no action was taken on transfer of credits. So this would not be a component part.

Mr. HUGHES. If these were not enacted the higher normal cost would not prevail. The social security minimum was not a transfer of credits provision. It was simply a provision that statutory revision of the civil service retirement laws provide that minimum civil service benefits would be equivalent to minimum social security benefits.

Mr. DANIELS. Would an employee be obliged to contribute to the cost of that?

Mr. HUGHES. There would be an employee benefit stemming from that, and he would pay one-half of the cost of that. I used the figure 1.85 percent before. That would be the employee's share of the cost of the benefit, and 1.86 percent would be paid by the agencies as the Federal share.

Mr. DANIELS. Your testimony, for the most part, is directed to the future unfunded liability of the fund. With respect to the present contingent liability of \$48,100 million, is it proposed that anything be done to take care of its financing?

Mr. HUGHES. Not per se, Mr. Chairman. We have instead, as you mentioned, proposed to cover future accruing unfunded liabilities as they accrue on this 30-year amortization basis which I described. Then beyond that we would propose that provision be made that the fund not drop below its highest level or below the employee equity, whichever is the higher.

As the actuaries now look at the fund the highest level of the fund would be about \$21 billion.

Mr. DANIELS. Why is it not necessary to take care of the present unfunded liability of \$48,100 million? Why are we permitting that unfunded liability to stay put, so to speak?

Mr. HUGHES. I think that is really the \$64 question, Mr. Chairman. We propose that the liability which represent benefits to be paid out over 30, 40, 50 years in the future, can be funded and met on a pay-as-you-go basis subject to the maintenance of the fund at a minimum level as I have suggested.

It is our view that the full faith and credit of the Government, its obligation to its employees, requires it to meet that unfunded liability as it comes due. However, it is not due at the present time. Therefore it is not necessary to fund it at the present time, and funding at the present time, as we see it, would provide no greater assurance than now exists to employees that their retirement benefits will be met as they come due.

Mr. DANIELS. Inasmuch as the full faith and credit of the United States is pledged for payment to the Federal employees of their future retirement benefits why is it necessary to consider the legislation which was recommended by Mr. Macy before this committee?

Mr. HUGHES. We see several reasons, Mr. Chairman. First, in the future there will accrue additional unfunded liabilities, and we think that some statutory provision is desirable to meet these as they accrue, simply to provide for orderly financing on some kind of a scheduled basis.

Second, there is no question but that employees and employee organizations and others are concerned about the status of the fund and about the size of the unfunded liability, and that these organizations and people would be concerned over any decline in the size of the fund which in their view jeopardizes its capacity to pay benefits. In these circumstances, partly for reasons psychological rather than financial, we have proposed that the fund be stabilized at essentially its present levels or higher. There is about \$17 billion in the fund at the present time, I believe. Its peak level under proposed financing arrangements would approximate \$21 billion.

We believe that if the Federal Government enters into a statutory obligation to maintain the fund at its highest level, \$21 billion, or the employee equity—the total amount of employee contributions in the fund which have not been disbursed for benefits—more than adequate assurance would be provided to those concerned over actuarial funding—not recognizing, as we see it, the difference between the Federal Government retirement system in this regard and an individual employee annuity purchased through, perhaps, a private insurance company.

Mr. DANIELS. With reference to the pegging of the fund, you state that you may do it either by taking the figure of the highest yearend balance or the employees' equity, whichever is the greater?

Mr. HUGHES. Yes.

Mr. DANIELS. What do you mean by the highest yearend balance?

Mr. HUGHES. I think the Comptroller General's report has a convenient table which could be used to illustrate, Mr. Chairman. I can just make reference to it and you will not need to refer to it. The record could, perhaps, incorporate it. It is a useful table on page 29 of his report to the Congress of April 1967.

That page has two different tables, one above the other. The top one reflects the effect of the Cabinet Committee's recommendation to peg the fund balance. The bottom one reflects an alternative approach which the GAO suggests for consideration under which appropriations would be made in the amount of the interest on the unfunded accrued liability.

The fourth column in the table, showing the Cabinet Committee's recommendation, reflects the trend in fund balance starting in fiscal year 1966.

In any event, the balance would increase from \$16.7 billion in that year up to \$21.2 billion in 1975, at which level the Cabinet Committee has proposed that the balance be stabilized; not allowed to increase further or to decrease further.

On the other hand, an appropriation equivalent to the interest on the unfunded accrued liabilities as shown by the bottom table would increase the fund up to a level of around \$59 billion by the year 2015. I think the comparison of these tables reflects in concise form these two alternatives.

The \$21 billion is substantially higher than the employee equity would ever be, as the actuaries now look at it. The employee equity maximum would approximate \$17 billion, as I understand it. So, pegged as we suggest, the fund would be at a level of about three times the maximum disbursements in any single year on the one hand, and secondly, would substantially exceed the total employee equity and we feel this is a very adequate amount for purposes of assurance of benefit availability and fund liquidity.

Mr. DANIELS. In looking at these two tables, I note that in your proposal the unfunded liability would grow to \$86 billion, whereas in the GAO proposal it does not exceed in any given year any more than \$50 billion.

Mr. HUGHES. Yes, sir. The effect of paying interest on the unfunded liability is to stabilize the unfunded liability.

As I have tried to indicate, we see no need to do that at this point in time. The essential thing is, first of all, to reveal the full costs of pay increases and of hirings, of employees on the roll associated with

Government programs. That is important and this should include the retirement cost as well as the active pay costs. Beyond that, it seems to us that the Federal Government clearly has an obligation to meet the retirement benefit liabilities and that it can meet these liabilities on the basis which we have suggested better than by funding on a stabilization of liability basis.

Mr. DANIELS. Inasmuch as the House meets at 11 o'clock this morning, there will not be sufficient time for us to fully explore the testimony you have given us this morning. I am going to suggest that it may be desirable that you or Mr. Schultze again appear at some future date.

Mr. HUGHES. We will be pleased to do that.

Mr. DANIELS. I yield to my colleague from North Carolina, Mr. Henderson.

Mr. HENDERSON. Thank you, Mr. Chairman.

On page 4, the second paragraph, you say what I have been trying to say for several years, better than I have ever been able to say it or my staff has ever been able to present it for me.

It is essential to good budgeting that each federal program be judged and evaluated in the light of its full costs.

You go on to say that—

In assessing the costs and benefits of a federal education program, or a farm loan program, or an urban housing program, the full costs of the federal manpower used in administering the program should be included in the calculation.

My big complaint over the years has been that the Bureau of the Budget, even though it was interested in this procedure, has not required this of the various agencies.

Another failing is that the committees of the Congress, who are concerned with getting at the problems of urban housing or farm problems, or the education program have not concerned themselves specifically with the full cost that you are talking about here.

Then, over on page 5, the section at the bottom:

The principle of full-cost coverage for currently accruing service liabilities is not so much a matter of financing, but of full-cost disclosure. We ought to know what the full costs of any federal program are.

I just hope we can take from the position that you have pointed out here with regard to the cost of retirement, that we need to review our efforts to fully inform the Members of Congress, as well as the Executive, that the cost of ongoing programs or the cost of new programs is not just the amount of money that Congress sets up in, say, its grant program or a loan program, but it is every one of those. We have got to figure in not only the direct cost of the manpower, but the indirect cost of health benefits. Here we are talking about retirement. This is so well done, Mr. Chairman, I don't think I need to ask any questions except to say that I hope the Bureau of the Budget will try to fully inform the Congress on the costs of these new programs. You are responsible for insisting that the agencies supply the necessary information.

Certainly, as we have talked about the cost of doing jobs in-house as compared to contracting, this retirement cost is something we have to consider on every in-house calculation and it is not a cost of contracting. I am sure that you appreciate this; but the present system we have today, in my opinion, does not fully inform us when we are

voting on these programs, as to what the costs are. We have to start doing this or we are not being fair with our own good conscience and with that of the taxpayers.

I appreciate the statement, Mr. Chairman. I do think we will need more time to talk about the retirement aspects, but I think this is well done and I am inclined to send this to every committee chairman in the House of Representatives.

It ought to be brought to the attention of the other body, but I wouldn't presume to do that.

Thank you, Mr. Chairman.

Mr. JOHNSON. I agree your statement is very well prepared and is in good language. It seems to me you have made a really, let's say far-reaching and novel statement here today wherein you say, "Well, it is not necessary to fund the retirement system up to \$48 billion, that it is all right, being the U.S. Government, if we just maintain it at a balance of around \$21 billion by reason of the fact that the full faith and credit of our Nation is behind the fund."

Is this the first time that, let's say, the Bureau of the Budget or the Government has come forth with this new concept, that the fund would be financially deficient, yet not financially irresponsible because the full faith and credit of the Government is back of it.

Mr. HUGHES. I think a short answer would be no; this is not the first time this particular point has been made, that the retirement funds, this one and in the same sense the social security fund, are not fully funded and, as far as I know, nobody at the present time is seriously proposing that they be fully funded.

The Comptroller General's alternative here suggests, as I read his letter, an alternative that would stabilize the unfunded liability at \$50 billion instead of some higher figure.

Mr. JOHNSON. I want to ask one more question: You say it would take a \$48 billion balance to properly fund our retirement system. Do you have any idea how much money it would take to, let's say, properly fund the social security system today?

Mr. HUGHES. No, I don't.

Mr. JOHNSON. Wouldn't it be, let's say, \$150 billion?

Mr. HUGHES. It would be a very substantial figure. I don't have it.

Mr. JOHNSON. Don't you think maybe the Federal Government in taking this policy that we are not going to fund the retirement system and we are not going to fund the social security system, that we are spreading ourselves out frightfully thin to a point where we really ought to express it in terms of the national debt—this huge liability of the Government?

Mr. HUGHES. First, this is not a new policy in any sense. This has been a bipartisan practice, I guess you could say, over the last 15 or 20 years that I have had some familiarity with the problem.

If I remember correctly, President Eisenhower vetoed a bill to provide normal cost-plus-interest funding of the civil service retirement fund, so that the concern here is a general concern and the issue of public policy is a serious question which we feel can be best answered and resolved in the context of the kind of a modified pay-as-you-go system which we have suggested.

Mr. JOHNSON. Thank you very much. My time has expired.

Mr. THOMPSON. Let me first say I am not at all satisfied with the statement. In fact, when we first looked into this matter, we were coming up with an additional amount that we expected employees to pay and an additional amount the Government would pay to put this on a more sound actuarial basis than it has been. Now we are told, let's forget about past unfunded liabilities. This is not important. Let's take care of future unfunded liabilities.

This is the statement you made?

Mr. HUGHES. I think you are misquoting me. I don't think I ever said forget about past liabilities.

Mr. THOMPSON. I said, let's don't do anything about—

Mr. HUGHES. I said let us not now fund for past accrued liabilities.

Mr. THOMPSON. Let's take care of it in the future.

Mr. HUGHES. That is right.

Mr. THOMPSON. In your statement, you made the statement:

The real problem of civil service financing is primarily one of budgetary and legislative responsibility.

And then you state that the soundness could not be improved upon by substituting bonds for a promise, so to speak, of the Congress.

If I were an employee, I would rather have my retirement fund funded by bonds rather than by the promise of the Congress or elected officials. I know the elected officials are responsible, but at the same time we don't know what can transpire in the future, or what demands will be on these officials; what they will consider to be important.

Mr. HUGHES. A bond is just a promise, Mr. Thompson.

Mr. THOMPSON. It seems what we have done by not having this fully funded, we are foregoing the interest that would be accruing on this fund which would accrue to the benefit of the employees. If we had this \$50 billion drawing interest, then it would accrue to the benefit of the employee.

Now, further, we are limited by law, of course, as to the type investment which you can make on this. We are limited to Government bonds which are low yield.

This works to the disadvantage of the employee because all other pension plans, of the private concerns, such as A.T. & T., General Motors, Delta Airlines, and so forth, are invested in securities which give a higher yield. Now, maybe you can say ours is more secure and there is more protection, but the employee is giving up a lot in this. He is giving up growth and he is giving up income and I question whether or not the bill, as presented, is fair to the employees when we say the Government is going to share 50 percent of this increase and the employee is going to share 50 percent. I think the Government is getting the lion's share of the benefits when we are limited to the Government bond investments and when we are going to take more money out of the employees' pay to create a bigger pool that can be used to buy Government bonds. This concerns me.

Mr. HUGHES. I think there are essentially three points. First, the question of the validity of the Federal Government's undertaking a bond promise, as distinguished from a retirement-fund promise.

Mr. DANIELS. We started to talk first about not taking care of the \$48 billion to \$50 billion unfunded liability.

Mr. HUGHES. Clearly it seem to me—

Mr. DANIELS. Let that stay put, as I used the word. Let that stay as it is.

Mr. HUGHES. Subject to the provision that the fund not be allowed to decline below its highest level or the amount of employee equity, whichever is the higher.

Now that unfunded liability accrues over a period of a long number of years in the future. The Government, as I see it, clearly has promised to pay that liability, to pay the benefits that accrue as a consequence of Federal service and that promise, as we see it, is equally as valid and as firm as is a promise to pay interest on Government bonds. We see no distinction between the two. If the Government cannot be relied upon to pay its statutory obligations to employees, then it seems to us it can no more be relied upon to pay its statutory obligation to bondholders.

Mr. THOMPSON. Then basically what you are saying is, there is no need to have any fund whatsoever. Why should we deduct anything from the wages of the employees because this is a promise of the Government at some future? Why don't we, as people retire, just make appropriations and forget about any funding?

Mr. HUGHES. That raises an entirely different question. That raises the question as to whether the system should be contributory. We have espoused and do continue to espouse the proposition that employees should pay for a portion of their retirement, that this portion should be 50 percent of a normal cost and the proposal which we have made would continue that.

Mr. HENDERSON. Would the gentleman yield right on that point? Couldn't we compare our military retirement system right here on this point as not being a contributory system?

Mr. HUGHES. That is right.

Mr. HENDERSON. Or one that has a fund?

Mr. HUGHES. That is right.

Mr. HENDERSON. The military system of our Nation is the type of obligation retirement fund you have suggested that to a certain extent would be true here, even in the contributory-type retirement.

As we consider the obligation of the Federal Government to people who work for it, when we think about the military, when we think about the civilians, the point could well be made that we do have that type system for the military and we have a very similar obligation.

Mr. HUGHES. That is true.

Mr. HENDERSON. When you put together the entire picture of what is the obligation of the Federal Government to the people who have worked for it, you have the civil service retirement, the military, and the veterans—the staff tells me military retired pay for fiscal year 1968 equals \$2.02 billion. The veterans' pension fund is \$4.4 billion of obligation of the Government in this fiscal year.

Mr. JOHNSON. That is the current-year obligation?

Mr. HENDERSON. That is right.

Mr. HUGHES. Essentially, Mr. Thompson, I think the point I was trying to make was that both the Federal Government's retirement obligation and its bond obligations are statutory obligations of the Government. They are equivalent, as we see it, in terms of their validity

and in those circumstances no greater assurance is provided the employee by the deposit of bonds—obligations, promises to pay in the fund—than is provided by initial promise of the Government to pay retirement benefits.

Mr. THOMPSON. If this is true, then I question whether we are going about this in the right way or not. If we are going to say we are not going to make this a fully funded fund and that a promise is as good as a bond, and considering the military, and so forth, where we are doing this, then perhaps we should go to a completely noncontributory type of retirement fund. The Government is getting the use of the money they take from the employees by controlling the fluctuation of the market in buying Government bonds and the money deducted from the employees can be used only for the purchase of Government bonds. Certainly the Government derives some benefit from this.

I want to give this a lot more thought myself.

Mr. HUGHES. I would like to talk to two other points which you made. One of these is with respect to interest, and the fact that the fund and therefore the employees are penalized because the fund is not fully funded. Again, it seems to us the essential requirement is that the obligation be paid. The retirement benefit obligation. The employees do not pay half of the costs of retirement benefits. This is important to keep in mind. That was, I think, the implication of your statement. They, rather, pay half of the normal cost. There is overhanging the Federal obligation, the substantial unfunded accrued liability, part of which relates to present employees and requires the payment of benefits to them substantially in excess of the normal costs of the system: pay raises, benefit increases, and so on, which all increase the retirement costs above those normal costs as the term is used in actuarial calculations. So that the Federal share of total retirement benefits is substantially higher than 50 percent. The total Federal payments in support of the Federal system are far more than 50 percent and will continue to be so as far as we can see, at least, into the future.

The third point which I recall your making was with respect to the possibility of investing the retirement fund in private obligations which would earn higher interest rates in most cases than the obligations, the issues which the fund buys from the Treasury.

I think essentially it is true there is an interest differential. The interest differential is not the differential between 3.5 and some higher rate, whatever it would earn in the private market. Under present circumstances the issues, the Government issues now are earning somewhere between 4.5 and 5 percent—still below private rates, however.

However, there is also the question of the relative security of investments in Government bonds versus investments in the private market. Certainly the trustees of the fund could be depended upon to minimize the risk but there would remain a somewhat greater risk than with Government securities.

Mr. THOMPSON. But we would still have this ironclad promise, wouldn't we?

Mr. HUGHES. We would, indeed; and that gets me to the last problem here. I think this is the question of how the Government would manage its private investments of a fund ranging up to \$50, or \$80 billion, depending on the system of funding used. It is a little difficult for us to see—well, there are some real questions of public policy here.

With these kinds of moneys invested in General Motors stock or American Telephone & Telegraph or what have you—in the course, for instance, of labor negotiations between the firm and its employees we have a serious issue of public policy which, thus far, anyway, has been resolved on the side of avoiding use of Federal retirement moneys for investment in the private market because it does raise these very difficult problems.

We pay a price for that but, again, the Federal Government is different. It is the sovereign and it has other responsibilities which both enable it and require it to act somewhat differently than it would if it were a private employer.

Mr. DANIELS. Mr. Hughes, the bells have rung and a quorum call is taking place on the House floor. Therefore, we will have to suspend.

I feel, in view of the questioning that has taken place, that it will be necessary either for yourself or for the Director of the Bureau of the Budget, Mr. Schultze, to appear here at some future date so that we can continue this discussion.

The committee, then, will stand adjourned until 10 a.m. tomorrow morning, when the Honorable Elmer B. Staats, Comptroller General of the United States, is expected to appear.

(Whereupon, at 11:10 a.m., the subcommittee was recessed, to reconvene at 10 a.m., Wednesday, November 15, 1967.)

RETIREMENT FINANCING

WEDNESDAY, NOVEMBER 15, 1967

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON RETIREMENT, INSURANCE, AND HEALTH BENEFITS OF THE COMMITTEE ON POST OFFICE AND CIVIL SERVICE,

Washington, D.C.

The subcommittee met at 10 a.m., pursuant to recess, in room 210, Cannon House Office Building, Hon. Dominick V. Daniels (chairman of the subcommittee) presiding.

Mr. DANIELS. The subcommittee will come to order.

The Subcommittee on Retirement, Insurance, and Health Benefits is meeting again this morning for the purpose of continuing the consideration of legislation designed to improve the financial structure of the Civil Service Retirement System.

As part of its audit of the U.S. Civil Service Commission, the General Accounting Office has reviewed the present method of financing the system. As a result of that review the Comptroller General, under date of April 24, 1967, issued a report to the Congress outlining an alternative approach to that recommended by the President's Cabinet Committee on Federal Staff Retirement Systems.

Without objection, the report, B-130150, will be incorporated in the record at this point.

(The report is as follows:)

COMPTROLLER GENERAL OF THE UNITED STATES,

Washington, D.C., April 24, 1967.

B-130150.

To the President of the Senate and the Speaker of the House of Representatives:

The General Accounting Office has reviewed the present method of financing the Civil Service Retirement System administered by the United States Civil Service Commission.

Several different proposals for improving the financing of the System have been made in recent years. The most recent was contained in the report of the Cabinet Committee on Federal Staff Retirement Systems, submitted to the Congress by the President on March 7, 1966 (H. Doc. 402, 89th Cong.).

The General Accounting Office has outlined in this report an alternative approach for financing the Civil Service Retirement System which would provide for—

1. Agency contributions and deductions from employees' salaries, in such proportions as may be enacted into law by the Congress, to cover the full normal cost of the System.

2. Direct appropriations to the Civil Service Retirement and Disability Fund to amortize in level amounts over a 20-year period all future increments in the unfunded accrued liability; i.e., the accumulated costs of the System for which funds have not been provided.

3. Direct appropriations to the Fund under permanent indefinite authority in annual amounts equivalent to interest on the unfunded accrued liability which is expected to be about \$50.3 billion at June 30, 1967, if restrictions on the payment of certain benefits are removed.

An analysis and comparison of the effect of the Cabinet Committee recommendations and the alternative approach are presented in the report.

A major difference between the two proposed methods of financing the System is that the Cabinet Committee recommendations would postpone indefinitely recognition in the Government's administrative budget of some \$36 billion in future costs of the Civil Service Retirement System—measured by the difference between the amount of the unfunded accrued liability of about \$50.3 billion expected to exist as of June 30, 1967, and the amount of the unfunded accrued liability of approximately \$86 billion which would exist in the year 2015 or thereabouts and which would become stabilized at that time and at that amount under the Cabinet Committee's plan.

We believe that, in furtherance of the objective of prudent management of the Government's financial affairs, a consistent method of financing the System should be established that will recognize and provide for all costs of maintaining the System from year to year as the costs are incurred. The objective would be attained under our alternative approach and the unfunded accrued liability would become stabilized immediately.

There are many approaches that can be taken to improve the financing of the Civil Service Retirement System, two of which are explained in this report. It is our view that, regardless of the approach the Congress may choose to follow, it is important that a definite plan be adopted to improve the financing of the System at an early date.

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of the Treasury; and the Chairman, United States Civil Service Commission.

ELMER B. STAATS,
Comptroller General of the United States.

REPORT ON FINANCING THE CIVIL SERVICE RETIREMENT SYSTEM ADMINISTERED BY U.S. CIVIL SERVICE COMMISSION

INTRODUCTION

As part of its audit of the United States Civil Service Commission, the General Accounting Office has reviewed the present method of financing the Civil Service Retirement System administered by the Commission. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

At the request of the Senate Committee on Appropriations, we prepared a special report in October 1959 setting forth our conclusions and recommendations on financing the System. The report was furnished to the legislative and appropriations committees of the Senate and the House. Recently, the Cabinet Committee on Federal Staff Retirement Systems prepared a report, submitted by the President to the Congress on March 7, 1966, in which it included its recommendations on financing the System.¹ We are submitting this report outlining an alternative approach to financing the System in the belief that it may be of interest to the Congress in its continuing consideration of legislation on the subject.

BACKGROUND

Past and present methods of financing the Civil Service retirement system

Financing the Civil Service Retirement System, as the term "financing" is used in this report, refers to the establishment of credits in the Civil Service Retirement and Disability Fund. The Fund was created by the act of May 22, 1920, for the payment of benefits provided in the act. Credits are established when direct appropriations are made to the Fund; deductions are made from employees' salaries; contributions are made by employing agencies; interest is earned on investments; and, among other things, optional deposits are made by employees for past service credit.

Deductions have been made from employees' salaries since the inception of the Civil Service Retirement System in 1920.

No appropriations were made to the Fund during the first 8 years of the Fund's existence. However, appropriations from the general fund of the Treasury were made each year thereafter through fiscal year 1957, although the method for

¹ H. Doc. 402, 89th Cong., 2d sess.

determining the amounts of these appropriations was changed from time to time, particularly during the 8-year period from 1950 to 1957.

Effective with the first pay period beginning on or after October 1, 1956, the Civil Service Retirement Act was amended by Public Law 854. Eighty-fourth Congress, approved July 31, 1956, to raise the amount to be deducted from employees' salaries to the 6½ percent.² The same law provided that, beginning with the first pay period after June 30, 1957, matching contributions would be made by the employing agencies equal to the amounts deducted from employees' salaries. These contributions are made from the employing agency's appropriation or fund from which its employees' salaries are paid. The contributions and deductions have approached but have fallen somewhat short of equaling the annual normal cost³ of the benefits payable under the System.

Since introduction of the system of making matching contributions, no direct appropriations (as distinguished from matching contributions) have been made to the Fund except to meet the requirements of special legislation. Direct appropriations of approximately \$46 million and \$45 million were made for fiscal years 1961 and 1962 in consequence of Public Law 85-465, approved June 25, 1958. That act stated that the annuities and the increases in annuities which it provided were to terminate for each fiscal year beginning after June 30, 1960, unless an appropriation was made by the Congress to compensate the Civil Service Retirement and Disability Fund for the fiscal year's cost of such annuities and increases in annuities. Public Law 87-114, approved July 31, 1961, amended Public Law 85-465, however, by eliminating the requirement for such appropriations.

Direct appropriations of \$30 million, \$62 million, \$65 million, \$67 million, and \$73 million were made for fiscal years 1963, 1964, 1965, 1966, and 1967, respectively. These appropriations were made to cover the payments expected to be made during the respective fiscal years for new and increased annuity benefits provided by part III of Public Law 87-793, approved October 11, 1962. Part III provided for a 5-percent increase in annuities in effect on January 1, 1963; increases of from 1 to 4 percent in annuities commencing between 1963 and 1966; cost-of-living adjustments of annuities, none of which were made under part III but are now being made under subsequent legislation; and other liberalizations of benefits.

These appropriations were required because of the provision in the Independent Offices Appropriation Act, 1959, Public Law 85-844, approved August 28, 1958 (now 5 U.S.C. 8348(g)), that no moneys in the Civil Service Retirement and Disability Fund shall be applied toward the payment of any increase in annuity benefits or any new annuity benefits which may be authorized by subsequent amendments to the Civil Service Retirement Act unless an appropriation is made to the Fund in an amount estimated by the Civil Service Commission to be sufficient to prevent an immediate increase in the unfunded accrued liability⁴ of the Fund. With the exception of Public Law 87-793, other laws providing for new or increased annuity benefits and enacted subsequent to Public Law 85-844 contained exemptions to the restriction imposed by that act.

A table showing the receipts, disbursements, and balances in the Civil Service Retirement and Disability Fund from inception through fiscal year 1966 is included as appendix I. Contributions by the Government in the form of direct appropriations and contributions by the employing agencies are shown separately in appendix II.

² The amount deducted from "Members," i.e., Members of Congress and certain other officials, was raised to 7½ percent.

³ Normal cost is described in the report of the Cabinet Committee as follows:

"Normal cost" means the cost of benefits being earned now and to be earned in the future, expressed as a level percentage of salary to be paid into the retirement funds each year for each employee in the service. These amounts, together with interest they earn when invested, will fully cover prospective cost of the benefits for employees and their survivors."

The normal contribution rate applicable to the Civil Service Retirement System is described by the System's Board of Actuaries as the average percentage of the salaries of new employees that is required to be paid into the fund from the time they enter service until they leave service in order to accumulate sufficient funds to pay their benefits.

⁴ The term "unfunded accrued liability" refers to an amount by which the balance in the Civil Service Retirement and Disability Fund, expected future contributions from the Government, and expected future deductions from employees' salaries, plus interest expected to be earned thereon, is less than the amount required to meet all benefits in full as they become payable. The Civil Service Commission generally refers to this amount as the "deficiency."

Unfunded accrued liability

Matching contributions are not sufficient to meet all the Government's portion of the cost of the retirement system. This is owing principally to the existence of an unfunded accrued liability which the Civil Service Commission estimated to be \$44 billion at June 30, 1966.⁵

Many factors have contributed to the existence and growth of this unfunded liability. Employees were given credit for service rendered prior to the establishment of the Civil Service Retirement System in 1920. No contributions were made to the Fund for this service by either the employees or the Government. Also, in early years no appropriations were made either to cover the normal cost based on current service or to reduce the unfunded accrued liability based on prior service and in some years when appropriations were made they were less than the normal cost. Allowing credit for periods of military service increased the unfunded liability. And the liability has grown as a result of increases in the level of benefit payments and increases in salary rates.

The Civil Service Commission has estimated that the unfunded accrued liability increased by approximately \$3.7 billion in fiscal year 1966 and that it will increase by approximately \$4.1 billion in fiscal year 1967. The increase during the fiscal year 1966 was attributed principally to three factors. Approximately \$1.1 billion was attributed to salary increases provided by Public Law 89-301, approved October 29, 1965; approximately \$1.1 billion was attributed to annuity increases provided by Public Law 89-205, approved September 27, 1965, and Public Law 89-314, approved November 1, 1965; and approximately \$1.5 billion was attributed to the fact that interest or its equivalent was not received on the amount of the unfunded accrued liability.

Of the expected increase of approximately \$4.1 billion in the unfunded accrued liability during fiscal year 1967, approximately \$1.6 billion was attributed to salary increases and annuity increases provided by Public Law 89-504, approved July 18, 1966; approximately \$0.7 billion was attributed to a cost-of-living adjustment in annuities, effective January 1, 1967, made in accordance with the provisions of Public Law 89-205, approved September 27, 1965; and approximately \$1.6 billion was attributed to the fact that interest or its equivalent will not be received on the amount of the unfunded accrued liability.

Normal cost plus interest

Section 8348(f) of title 5 of the United States Code—formerly section 17(e) of the Civil Service Retirement Act, added in 1956 by Public Law 854, Eighty-fourth Congress—provides that "The Civil Service Commission shall submit estimates of the appropriations necessary to finance the Fund on a normal cost plus interest basis * * *."

In explaining the inclusion of section 17(e) in the bill which became Public Law 854, Eighty-fourth Congress, the managers on the part of the House stated in the conference report that the House Committee on Post Office and Civil Service had found that an essential ingredient to proper financing of the retirement fund was "appropriations by the Government in amounts which, when added to such contributions by the employees and matching contributions by the Government, will place in the fund each year the sum required to maintain it on a 'normal cost plus interest' basis."

The conference report stated also that the normal cost plus interest method of financing was recommended by the Board of Actuaries of the Civil Service Retirement System, by the Committee on Retirement Policy for Federal Personnel (created by Public Law 555, 82d Cong., to study all Federal retirement systems), and by independent actuarial and retirement authorities.

The "interest" portion of the normal cost plus interest basis refers to interest on the amount of the unfunded accrued liability. Appropriations in amounts to cover the Government's portion of the normal cost of the retirement system plus interest on the unfunded accrued liability would not reduce—but would prevent an increase in—the unfunded accrued liability, assuming of course that all relevant factors such as the level of benefit payments, salary rates, and expected rate of interest income on investments remained unchanged.

Also, it has been stated that the normal cost plus interest method of financing retirement funds will, in some cases, cover all disbursements to be made from the funds indefinitely. The Committee on Retirement Policy for Federal Personnel, in

⁵ The unfunded accrued liability would be approximately \$2.2 billion more if payment of new and increased annuity benefits provided by part III of Public Law 87-793 was not contingent upon prior appropriation of funds to prevent an immediate increase in the unfunded accrued liability.

its report issued in June 1954, stated that Government contributions on the normal cost plus interest basis, plus the balance then in the Civil Service Retirement and Disability Fund and future employee contributions, would be sufficient to cover all disbursements from that fund indefinitely.

The Civil Service Commission has not construed section 17(e), however, as requiring that appropriation requests be made on the normal cost plus interest basis, and no appropriations have been made on that basis since enactment of section 17(e).

Amounts required to finance system on normal cost plus interest basis

The following table, which summarizes estimates prepared by the Civil Service Commission, shows that the normal cost of maintaining the Civil Service Retirement System would be equivalent to 13.60 percent of payroll as of June 30, 1967. The employees contribute 6.5 percent of payroll toward the normal cost and the employing agencies also contribute 6.5 percent. Consequently, an additional amount equal to 0.60 percent of payroll, or \$105,228,000 a year, would be required to fully cover the normal cost of the System. The table shows also that an amount of \$1,681,812,000 a year, equal to 9.59 percent of payroll and equivalent to interest at 3½ percent on the estimated unfunded accrued liability as of June 30, 1967, would be required to complete the financing on a normal cost plus interest basis.

ESTIMATED AMOUNTS REQUIRED TO FINANCE CIVIL SERVICE RETIREMENT SYSTEM ON A NORMAL COST-PLUS-INTEREST BASIS (AS OF JUNE 30, 1967)

	Normal cost		Interest on unfunded accrued liability		Total	
	Percentage of payroll	Annual amount	Percentage of payroll	Annual amount	Percentage of payroll	Annual amount
Total.....	13.60	\$2,385,168,000	9.59	\$1,681,812,000	23.19	\$4,066,980,000
Deductions from employees' salaries.....	6.50	1,139,970,000	-----	-----	6.50	1,139,970,000
Agency contributions.....	6.50	1,139,970,000	-----	-----	6.50	1,139,970,000
Balance.....	.60	105,228,000	9.59	1,681,812,000	10.19	1,787,040,000

The preceding table includes the estimated amounts required to finance the cost of all benefits under the System provided by legislation enacted through the close of the Eighty-ninth Congress, other than the amounts required to finance the cost of new and increased annuity benefits provided by Part III of Public Law 87-793. The amount that would be required on the normal cost plus interest basis to finance the cost of these benefits was excluded because, as explained on page 4, their payment is contingent upon receipt of special appropriations. If special appropriations were not required, an additional amount of approximately \$123 million would have been included in the preceding table as the amount of the normal cost plus interest attributable to these benefits.

Appendix III shows the amounts, as estimated by the Civil Service Commission, that the Government would have to provide in various years over a 50-year period in the form of agency contributions, direct appropriations, and interest on Government securities held by the Fund in order to finance the System on a normal cost plus interest basis, assuming that agency contributions equal to deductions from employees' salaries continue to be made as at present.

Appendix III shows also that, according to the Civil Service Commission estimates, financing the System on a normal cost plus interest basis would eventually result in accumulating a balance in the Fund that would produce an annual amount of interest income which, with other receipts, would equal the benefit payments to be made each year. This is the condition previously referred to as being sufficient to cover all future disbursements from the Fund indefinitely. The unfunded accrued liability and, eventually, the Fund balance would remain constant, but, because an unfunded liability would still exist, deductions from the salaries of future employees and Government contributions relating to their service would have to be relied upon in part to completely cover the benefits payable to current employees and annuitants.

Fund balance will be exhausted unless additional appropriations are made

Like any other disbursement of the Government, disbursements to the System's beneficiaries cannot be made without authority of law. General authority for

disbursement from the Fund is contained in 5 U.S.C. 8348(a) which states that the Fund is appropriated for the payment of benefits provided by the Civil Service Retirement System.

A Civil Service Commission projection shows, however, that, under the present practice of making contributions to the Fund in amounts equal to deductions from employees' salaries, the Fund balance will be exhausted by 1987 (see app. IV). Unless additional appropriations are made from that year forward, the amount that can be disbursed at that time will not be sufficient to pay annuitants. The amount that the Government will then have to provide in the form of agency contributions and direct appropriations, as estimated by the Civil Service Commission, is shown in appendix IV.

NEED TO ESTABLISH ADEQUATE AND CONSISTENT METHOD OF FINANCING THE CIVIL SERVICE RETIREMENT SYSTEM

Although the Civil Service Retirement System is as sound financially as the faith and credit of the United States, we believe that, in furtherance of the objective of prudent management of the Government's financial affairs, an adequate and consistent method of financing the System should be established.

At present, only the following amounts are being paid or contributed to the Civil Service Retirement and Disability Fund.

1. Deductions from employees' salaries at 6½ percent.
2. Matching contributions made by the employing agencies.
3. Annual appropriations to finance the estimated cost of new and increased annuity benefits provided by part III of Public Law 87-793, approved October 11, 1962.
4. Interest on United States Government securities held by the Fund, appropriated as interest on the public debt. (The average interest rate at February 28, 1967, was approximately 3.7 percent.)

The following additional amounts would have to be paid or contributed to the Fund to provide for the full annual cost of the Civil Service Retirement System.

1. The excess of the normal cost of the System over the amounts provided by agency contributions and deductions from employees' salaries.
2. Interest on the unfunded accrued liability.
3. The amount of any future increase in the unfunded accrued liability.

None of that portion of the cost of maintaining the System represented by the present unfunded accrued liability, estimated at \$44 billion at June 30, 1966, has ever been provided for in the Federal budget or reflected in the budget surplus or deficit.

Cabinet committee recommendations

Several different proposals for improving the financing of the System have been made in recent years. The most recent proposal was contained in the report of the Cabinet Committee on Federal Staff Retirement Systems, prepared in response to a request of the President for a review of Federal retirement policies and benefits. The report, submitted by the President to the Congress on March 7, 1966, was printed in House Document 402, Eighty-ninth Congress.

The Senate Committee on Appropriations, in commenting on this report, stated:

"The report of the Cabinet-level committee printed in House Document No. 402 contains recommendations for stabilizing this liability [the unfunded accrued liability] which the committee believes should receive careful consideration by the Congress. Eventually the Congress must face up to the problem and provide annual appropriations on a systematic basis which will pay the full cost of the retirement program as well as to stabilize the unfunded liability."

Also with respect to the same report, the House Committee on Appropriations stated:

"The Committee is of the opinion that these recommendations should receive careful consideration by the Congress. The taxpayer has a deferred obligation that must be paid at some time in the future. The Government is not now paying its full costs with annual appropriations on a systematic basis."

The Cabinet Committee recommendations were designed to provide for—

1. Agency contributions and deductions from employees' salaries in equal amounts to cover the full normal cost of the Civil Retirement System, except the normal cost of changes in the System designed to improve management, which would be covered solely by contributions from the agencies.

2. Direct appropriations to the Civil Service Retirement and Disability Fund to amortize over a 30-year period in progressively increasing amounts any future increments in the unfunded accrued liability except those arising from increases in annuities attributable to increases in the Consumer Price Index (cost-of-living adjustments).

3. Direct appropriations under permanent indefinite authority to ultimately peg the Fund balance at a specified level equal to or in excess of employee equity and to ultimately stabilize the existing unfunded accrued liability.

General Accounting Office alternative approach to financing the Civil Service Retirement System

The following alternative approach to financing the Civil Service Retirement System is set forth herein for possible consideration by the Congress. This approach would provide for—

1. Agency contributions and deductions from employees' salaries, in such proportions as may be enacted into law by the Congress, to cover the full normal cost of the System.

2. Direct appropriations to the Fund to amortize in level amounts over a 20-year period all future increments in the unfunded accrued liability.

3. Direct appropriations to the Fund under permanent indefinite authority in annual amounts equivalent to interest on the total unfunded accrued liability.

As will be brought out in the sections that follow, the Cabinet Committee recommendations and our alternative approach differ with respect to—

the method for determining the proportion of normal cost to be contributed by the agencies and the proportion to be deducted from employees' salaries; the period and the level at which appropriations would be made to amortize future increments in the unfunded accrued liability; and

the amount of the additional appropriations required to peg the Fund balance at a specified level in one case and to provide for amounts equivalent to interest on the unfunded accrued liability in the other.

These differences would result in differences in the size of the Fund balances that would be accumulated, differences in the level at which the existing unfunded accrued liability would become stabilized, and differences in the length of time required for it to become stabilized. These differences would result also in differences in the amounts of expenditures to be recognized in the administrative budget each year, consequently, in differences in the amounts of the budget deficits or surplus.

Financing normal cost

Credits to the Civil Service Retirement and Disability Fund arising from contributions by the employing agencies and deductions from employees' salaries are not sufficient to cover the normal cost of maintaining the Civil Service Retirement System. The estimate of the Civil Service Commission shows that the estimated normal cost of maintaining the retirement system is equivalent to 13.60 percent of the expected annual payroll as of June 30, 1967. Deductions from employees' salaries amount to 6.5 percent of payroll and agency contributions amount to 6.5 percent, a total of 13 percent. Thus, the excess of the normal cost over the amounts provided by agency contributions and by deductions from employees' salaries is estimated at 0.60 percent of payroll. On this basis, the additional amount that would be required to cover the excess would be approximately \$105 million.

In commenting on our earlier proposal that appropriations be made to cover the excess of normal cost over the amounts provided by agency contributions and deductions from employees' salaries, the Civil Service Commission stated that it agreed that normal costs should be fully funded and that they should be funded on a current basis. The Commission stated that it would prefer, however, to see this funding accomplished through employee and agency contributions rather than through establishment of an additional annual appropriations requirement over and beyond those contributions.

In explanation, the Commission stated that the present method of using agency contributions plus deductions from employees' salaries to meet normal retirement costs is already well established and well understood and it is simple, efficient, and highly effective. The Commission also stated that it would like to preserve

those advantages by extending the same method (adjusted, if necessary, to reflect a different cost-sharing ratio) to cover the full normal cost of the System.⁶

The Bureau of the Budget endorsed the recommendation of the Cabinet Committee under which the full normal cost of existing benefits and future liberalizations thereof would, with one exception, be shared equally by the employees and the agencies. The exception relates to the normal cost of future changes in the Civil Service Retirement System designed to improve management, which cost would be covered solely by agency contributions. An example of such a change is the Cabinet Committee proposal that normal retirement age be changed from 70 years after at least 15 years of service to 65 years after at least 5 years of service, with authority being given to agency management to retain employees on a selective basis for year-to-year employment up to age 70.

After considering the views of the agencies concerned with the financing of the Civil Service Retirement System, we are inclined to agree that the full normal cost of the System should be financed by agency contributions and by deductions from employees' salaries. We believe, however, that the Congress may wish to consider covering the full normal cost of the System through agency contributions and deductions from employees' salaries in proportions other than equal proportions and establishing in law the specific cost-sharing ratio to be followed.

Financing future increases in the unfunded accrued liability

Each increase in salary rates and each increase in the level of benefit payments for current employees causes an immediate increase in the amount of the unfunded accrued liability as well as an increase in the normal cost of providing for benefit payments. This is because there is an increase in the cost of providing benefit payments based on prior service as well as an increase in the cost of providing benefit payments based on current and future service. Increases in the level of benefit payments to those on the annuity roll cause immediate increases in the amount of the unfunded accrued liability. In addition, changes in the retirement system other than increases in salary rates or in the level of benefit payments may result in increases in the amount of the unfunded accrued liability and in the normal cost.

Changes in actuarial assumptions also may affect the amount of the unfunded accrued liability. For example, use of a revised assumption based on an increase in life expectancy will result in an increase in the amount of the unfunded accrued liability. A decrease in the interest rate used in the actuarial calculation will result in an increase in the amount of the unfunded accrued liability as well as in the normal cost, whereas an increase in the interest rate will result in corresponding decreases.

It is our opinion that appropriations should be made to cover future increases in the unfunded accrued liability arising from increases in the cost of providing benefit payments based on prior service, from changes in actuarial assumptions, or from other causes. Such appropriations could be made to liquidate the increase in full in the year in which the increase takes place.

A preferable method, in our opinion, would be to make annual appropriations to amortize—i.e., to provide for the gradual liquidation of—future increases in the unfunded accrued liability. Reductions in the unfunded accrued liability arising from changes in actuarial assumptions or from other causes would reduce the amount to be amortized. The amount subject to amortization would be the excess of the unfunded accrued liability at the end of any fiscal year over the amount of the unfunded accrued liability at the end of the fiscal year in which such a procedure would be adopted.

The Cabinet Committee recommended that direct appropriations be made to the Civil Service Retirement and Disability Fund to amortize over a 30-year period in progressively increasing amounts any future increments in the unfunded accrued liability except those arising from increases in annuities attributable to increases in the Consumer Price Index (cost-of-living adjustments). As an alternative, the Congress may wish to consider using a shorter amortization period and amortizing the amount of the increase in equal annual amounts rather than in progressively increasing amounts.

The following table compares the amounts of the annual appropriations that would be required to amortize a future increase of \$1 million in the unfunded

⁶ Comments of the Civil Service Commission, the Treasury Department, and the Bureau of the Budget on the draft of our report are included as appendixes V, VI, and VII.

accrued liability over a 30-year period under the schedule of progressively increasing amounts recommended by the Cabinet Committee and the amounts that would be required over a 20-year period under a schedule calling for level annual appropriations.

AMORTIZATION SCHEDULE FOR \$1,000,000 AT 3½-PERCENT INTEREST (1ST PAYMENT DUE UPON CREATION OF UNFUNDED LIABILITY)

30-year period, progressively increasing appropriations		30-year period, progressively increasing appropriations	
Year	Annual appropriation	Year	Annual appropriation
1.....	\$4,051	17.....	\$68,869
2.....	8,102	18.....	72,920
3.....	12,153	19.....	76,971
4.....	16,205	20.....	81,023
5.....	20,256	21.....	85,074
6.....	24,307	22.....	89,125
7.....	28,358	23.....	93,176
8.....	32,409	24.....	97,227
9.....	36,460	25.....	101,278
10.....	40,511	26.....	105,329
11.....	44,562	27.....	109,380
12.....	48,613	28.....	113,431
13.....	52,665	29.....	117,483
14.....	56,716	30.....	121,534
15.....	60,767		
16.....	64,818	Total appropriations...	1,883,773

20-YEAR PERIOD, LEVEL ANNUAL APPROPRIATIONS

Year	Annual appropriation	Year	Annual appropriation
1.....	¹ \$67,982	12.....	\$67,982
2.....	67,982	13.....	67,982
3.....	67,982	14.....	67,982
4.....	67,982	15.....	67,982
5.....	67,982	16.....	67,982
6.....	67,982	17.....	67,982
7.....	67,982	18.....	67,982
8.....	67,982	19.....	67,982
9.....	67,982	20.....	67,982
10.....	67,982		
11.....	67,982	Total appropriations...	1,359,640

¹ For purposes of comparison, the amount of each level annual appropriation includes an amount for interest. If the interest were to be included with the interest on the existing unfunded accrued liability, as would be the case under the General Accounting Office approach, the level annual appropriation required to liquidate a \$1,000,000 increase in the unfunded accrued liability over a 20-year period would be \$50,000.

The preceding table shows that, under the method proposed by the Cabinet Committee, the appropriation in the 15th year would be 15 times as much as the appropriation in the 1st year and that the appropriation in the 30th year would be 30 times as much as the appropriation in the 1st year.

In commenting on the alternative approach outlined in this report, under which annual appropriations would be made to amortize future increases in the unfunded accrued liability over a 20-year period, the Civil Service Commission stated that it agrees that it is desirable that definite and timely provisions be made to cover such increases. The Commission stated, however, that it saw no particular advantage to a 20-year period compared with a 30-year period for amortizing such amounts.

The Bureau of the Budget expressed a preference for the method of amortization recommended by the Cabinet Committee rather than for the method under which future increases in the unfunded accrued liability would be amortized in level annual amounts over a 20-year period. The Bureau stated that the advantage of the Cabinet Committee proposal lies in the fact that the annual appropriations would coincide more nearly with the actual payout of benefits and would avoid adverse effects of large fund accumulations in the early years.

It is our opinion that, if it is desirable to make appropriations to coincide with benefit payments, there would be no need to maintain any balance in the Fund.

We believe that the cost of providing increases in benefit payments based on prior service, which result in increases in the unfunded accrued liability, should be related to, i.e., spread over, the period of time that the Government can reasonably be expected to benefit from such actions. In our opinion, a 20-year period, which would approximate the mean of the average number of years of service of employees who work until retirement age plus the average number of years for which they receive annuities, would be appropriate for this purpose. The same period could be used for amortizing any future increases in the unfunded accrued liability resulting from changes in actuarial assumptions.

Additional financing

In calculating the amount of the contributions and appropriations that would have to be made to cover the cost of the Civil Service Retirement System, the amount of the interest expected to be earned on Fund investments is taken into account. If the contributions and appropriations are insufficient, the Fund will not earn the full amount of the interest expected to be earned. The amount of the deficiency in interest earnings, as well as the amount of the deficiency in contributions and appropriations, increases the unfunded accrued liability.

The deficiency in interest earnings attributable to the unfunded accrued liability expected to exist as of June 30, 1967, has been estimated by the Civil Service Commission to be approximately \$1.7 billion a year. This annual deficiency could be eliminated by making an appropriation to the Fund for the amount of the unfunded accrued liability or by making annual appropriations in amounts equivalent to the annual interest on the unfunded accrued liability, i.e., on the portion of the cost of maintaining the System for which appropriations were not made in prior years.

The Cabinet Committee did not specifically recommend that appropriations be made to cover interest on the unfunded accrued liability. The Committee did recommend that, in addition to financing full normal cost and the cost of future increases in the unfunded accrued liability, other financing be provided in the form of direct appropriations under permanent indefinite authority in amounts sufficient to peg the Fund balance at whatever maximum level it might attain under its other financing recommendations or at employee equity, whichever is the greater. Employee equity was defined as the total of active employee contributions, contributions of employees separated with vested rights, and contributions by beneficiaries net of benefits paid in their behalf.

According to a Treasury Department analysis, the amount of the additional financing that would be provided under this procedure would ultimately be equivalent to interest on the unfunded accrued liability. However, the additional annual appropriation would not equal the amount of interest on the unfunded accrued liability until about the year 2015. And, instead of a level annual appropriation of approximately \$1.7 billion that would be required if amounts equivalent to interest on the unfunded accrued liability were appropriated each year, the appropriation required under this part of the Cabinet Committee recommendations would ultimately reach \$3 billion a year.

In addition to considering the Cabinet Committee recommendation, the Congress may wish to consider our alternative approach under which annual appropriations would be made in amounts equivalent to interest on the unfunded accrued liability. This could be accomplished by annual appropriation action or by using the permanent indefinite appropriation procedure already established for making appropriations for interest on the public debt. Provision for the latter could be made by adding the following sentence to 5 U.S.C. 8334(a).

"Except for purposes of the limitation in the first sentence of section 21 of the Second Liberty Bond Act, as amended (31 U.S.C. 757b), the amount of the unfunded accrued liability for benefits payable under this act, as determined annually by the Commission, shall be considered to be part of the public debt, and interest thereon computed at rates determined in accordance with the method prescribed in the second and third sentences of 5 U.S.C. 8348(d) shall be paid annually to the fund pursuant to section 3689, Revised Statutes (31 U.S.C. 711(2)), and section 3698, Revised Statutes (31 U.S.C. 732)."

Without commenting on the public debt aspect, the Chairman of the Civil Service Commission stated that a permanent indefinite appropriation procedure would be a good approach to controlling growth of the unfunded liability. He stated, however, that, rather than employing the procedure to produce amounts equivalent to the annual interest on the unfunded liability, he would suggest that

it be used to maintain the Fund balance at its peak or at employee equity, whichever is the greater.

If this were done, he said, confidence in the integrity of the Fund would be assured because the balance would never drop; there would always be in the Fund an amount at least equal to that contributed by employees and former employees and still remaining to their credit; and there would be no excessive buildup of the balance in advance of the actual need for the money, yet availability of sufficient funds to ensure prompt and full payment of benefits without awaiting appropriation action to permit payments already due would be assured.

The position of the Civil Service Commission on this point is in accord with the recommendation of the Cabinet Committee that direct appropriations under permanent indefinite authority should be made in amounts sufficient to peg the Fund at whatever maximum level it might attain through implementation of the other financing recommendations of the Committee or at employee equity, whichever is the greater. Both the Bureau of the Budget and the Treasury Department stated or indicated that they supported the financing provisions contained in the Cabinet Committee's report.

The Bureau of the Budget, in explaining the considerations that led to the Cabinet Committee's recommendations, stated that annual appropriations of the amount needed to cover interest on the unfunded accrued liability would have a serious impact on the administrative budget. The Bureau went on to say that the necessary funds would have to be obtained by increased taxes or by an increase in the budget deficit and a concomitant increase in the total public debt.

In our opinion, making annual appropriations in amounts equivalent to interest on the unfunded accrued liability would not require raising taxes to cover the amount of the appropriations. Unless some means were adopted whereby the receipts from increased taxes could be set aside so that they would be available to make benefit payments as they become due, the receipts would be used for current Government expenditures or might possibly be used to reduce the public debt obligations held by the public. It would still be necessary, as it is now, to obtain funds from current tax receipts or from new borrowings from the public as the benefit payments become due. This is implicit in the Bureau's statement that the fact that Federal staff retirement systems are backed by the full faith and credit of the United States is generally accepted as assurance that all future benefit payments will be met.

Both our alternative approach and the Cabinet Committee recommendation would result in increased appropriations, although, under the Cabinet Committee recommendation, the larger appropriations would be deferred until the later years. The appropriations under either procedure would be recorded as budgetary expenditures and accordingly, the budget surplus would be reduced or the budget deficit would be increased. The alternative procedure, however, would result in recognizing the costs in the budget surplus or deficit as they are incurred rather than recognizing some costs on a gradually increasing basis with the bulk of the recognition being postponed until later years and recognition of some costs being postponed indefinitely.

If taxes were not raised or if there were no budget surplus, the increased appropriations under the alternative procedure would, as the Bureau of the Budget pointed out, also result in an increase in the total public debt, although they would not result in an increase in that portion of the public debt that is held by the public. But this would be true also with respect to the increased appropriations that would be required under the Cabinet Committee's recommendation.

No discussion of the effect of one method of providing additional financing in comparison with another method would be complete, however, if consideration were given only to the amount of the increased direct appropriations required under each method. Differences in the amounts of interest earned on Fund investments, all of which is received from Government appropriations, also must be taken into account. Consequently, we have prepared the following tables, based on figures included in estimates of the Civil Service Commission, showing the amount of the direct appropriations and the amount of the interest that would be earned on Fund investments under the Cabinet Committee's recommendation for additional financing and under the alternative method set forth herein for consideration by the Congress.

EFFECT OF CABINET COMMITTEE'S RECOMMENDATION TO PEG FUND BALANCE¹

[In billions of dollars]

	Direct appropriations	Interest on fund investments	Total direct appropriations and interest	Fund balance at end of year	Unfunded accrued liability
1966				\$16.7	\$44.0
1967	² \$0.1	\$0.6	\$0.7	17.8	³ 50.3
1968		.6	.6	18.7	
1969		.7	.7	19.5	
1970		.7	.7	20.2	
1975	.2	.7	.9	21.2	
1980	1.1	.8	1.9	21.2	
1985	1.9	.8	2.7	21.2	
1990	2.4	.8	3.2	21.2	
1995	2.7	.8	3.5	21.2	
2000	2.9	.8	3.7	21.2	
2005	3.0	.8	3.8	21.2	
2010	3.0	.8	3.8	21.2	
2015 and after	3.0	.8	3.8	21.2	⁴ 86.0

¹ These tables are based on benefit levels and other factors expected to exist as of June 30, 1967, including the effect of all legislation enacted through the 89th Cong.

² The direct appropriation of \$100,000,000 in fiscal year 1967 represents the special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and Subsequent fiscal years, a presumption was made that the requirement for special appropriations would be eliminated by legislative action.

³ The unfunded accrued liability of \$50,300,000,000 expected to exist as of June 30, 1967, includes an amount of approximately \$2,200,000,000 relating to increased benefits provided by Public Law 87-793. This amount was included on the assumption that the requirement for special appropriations would be eliminated.

⁴ Under the Cabinet Committee's recommendation, the unfunded accrued liability would increase each year until it reached a peak of approximately \$86,000,000,000 in the year 2015 or thereabouts. It would then become stabilized at that amount.

EFFECT OF GAO'S APPROACH UNDER WHICH DIRECT APPROPRIATIONS WOULD BE MADE IN AMOUNTS EQUIVALENT TO INTEREST ON THE UNFUNDED ACCRUED LIABILITY¹

[In billions of dollars]

	Direct appropriations	Interest on fund investments	Total direct appropriations and interest	Fund balance at end of year	Unfunded accrued liability
1966				\$16.7	\$44.0
1967	² \$0.1	\$0.6	\$0.7	17.8	³ 50.3
1968	1.7	.7	2.4	20.5	50.3
1969	1.7	.8	2.5	23.2	50.3
1970	1.7	.9	2.6	25.9	50.3
1975	1.7	1.3	3.0	37.6	50.3
1980	1.7	1.6	3.3	46.4	50.3
1985	1.7	1.8	3.5	52.0	50.3
1990	1.7	1.9	3.6	55.1	50.3
1995	1.7	2.0	3.7	56.9	50.3
2000	1.7	2.0	3.7	57.9	50.3
2005	1.7	2.0	3.7	58.4	50.3
2010	1.7	2.1	3.8	58.8	50.3
2015 and after	1.7	2.1	3.8	59.0	50.3

¹ These tables are based on benefit levels and other factors expected to exist as of June 30, 1967, including the effect of all legislation enacted through the 89th Cong.

² The direct appropriation of \$1,000,000,000 in fiscal year 1967 represents the special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and subsequent fiscal years, a presumption was made that the requirement for special appropriations would be eliminated by legislative action.

³ The unfunded accrued liability of \$50,300,000,000 expected to exist as of June 30, 1967, includes an amount of approximately \$2,200,000,000 relating to increased benefits provided by Public Law 87-793. This amount was included on the assumption that the requirement for special appropriations would be eliminated.

One of the factors advanced in support of the Cabinet Committee's recommendation was that the existing unfunded accrued liability of the System ultimately would become stabilized. As shown in the first of the two preceding tables, the existing liability would increase each year and would not become fully stabilized under the Cabinet Committee recommendation until the year 2015 or thereabouts and only after the accrued liability had reached approximately \$86 billion. Under our alternative method, the existing unfunded accrued liability would become stabilized immediately.

Another factor cited in support of the Cabinet Committee's recommendation was that the balance in the Civil Service Retirement and Disability Fund would be pegged at an amount equal to or in excess of employee equity. Employee equity is neither a measure of the Government's legal liability under the Civil Service Retirement System nor a measure of its accrued obligations under the

System. If appropriations to cover the full cost of maintaining the System are not to be made, we see no advantage in pegging the Fund balance at an amount equal to employee equity in preference to pegging it at any other balance from zero on up, except that confidence that the benefits under the System will be paid as they become due tends to increase in proportion to the size of the Fund balance.

As to considering the unfunded accrued liability as part of the public debt, the Treasury Department expressed the belief that to do so would establish an undesirable and dangerous precedent even though the amount would not be counted against the public debt limitation. The Treasury Department stated that, in its opinion, annual appropriations made under permanent indefinite authorization would be the more desirable method, i.e., the more desirable method of providing for the appropriation of amounts equivalent to interest on part or all of the unfunded accrued liability.

The present balance in the Civil Service Retirement and Disability Fund invested in Government securities (approximately \$17 billion at June 30, 1966), which has been accumulated to cover a portion of the cost of the Civil Service Retirement System, is considered to be a part of the public debt. However, that portion of the cost of maintaining the System represented by the unfunded accrued liability (approximately \$44 billion at June 30, 1966) has not been considered to be a part of the public debt. We find no logical support for the distinction. The Government's entire accrued obligation to make benefit payments under the retirement system, represented in part by the \$17 billion Fund balance and in part by the \$44 billion unfunded accrued liability, constitutes a debt of the Government, whether the \$44 billion is or is not recognized in the public debt statistics.

SUMMARY

Financing normal cost

Under the recommendations of the Cabinet Committee and under our alternative approach, agency contributions and/or deductions from employees' salaries would be increased to cover the full normal cost of the Civil Service Retirement System. The full normal cost is not being covered under present financing methods.

The Cabinet Committee recommended that, with one exception, the full normal cost be covered by agency contributions and by deductions from employees' salaries in equal amounts. The exception relates to the normal cost of changes in the System designed to improve management, which would be covered solely by contributions from the agencies.

The Congress, however, may wish to consider covering the full normal cost of the System through agency contributions and deductions from employees' salaries in proportions other than equal proportions and setting forth in law the specific cost-sharing ratio to be followed.

Financing future increases in the unfunded accrued liability

Under both the Cabinet Committee recommendations and our alternative approach, appropriations would be made to amortize—i.e., to gradually liquidate—any future increases in the unfunded accrued liability.

Under the Cabinet Committee recommendation, future increases in the unfunded accrued liability would be liquidated over 30-year periods through appropriations in progressively increasing amounts. As an illustration of the effect of appropriations in progressively increasing amounts, the appropriation in the 15th year would be 15 times as large as the appropriation in the 1st year and the appropriation in the 30th year would be 30 times as large as the appropriation in the 1st year.

Under our alternative approach, future increases in the unfunded accrued liability would be liquidated over 20-year periods through appropriations in level annual amounts.

Additional financing

The Cabinet Committee recommended that, in addition to financing full normal cost and the cost of future increases in the unfunded accrued liability, other financing be provided in the form of direct appropriations under permanent indefinite authority in amounts sufficient to peg the Fund balance at whatever maximum level it might attain under the Committee's other financing recommendations or at employee equity, whichever is the greater.

Under our alternative approach, direct appropriations under permanent indefinite authority would be made each year in amounts equivalent to interest on the unfunded accrued liability.

Both methods would stabilize the unfunded accrued liability. Under the Cabinet Committee recommendations, it would become stabilized in the year 2015 or thereabouts and only after the accrued liability had reached approximately \$86 billion.

Under our alternative approach, the unfunded accrued liability, which was expected to reach \$50.3 billion by June 30, 1967, would become stabilized immediately.

The balance in the Civil Service Retirement and Disability Fund would be expected to reach and to become stabilized at \$21.2 billion under the Cabinet Committee recommendation and would be expected to reach and to become stabilized at \$59 billion under our alternative approach.

The Cabinet Committee recommendation would ultimately result in annual appropriations of \$3 billion, which at that time would be equivalent to interest on the unfunded accrued liability of approximately \$86 billion.

Our alternative approach would result in level annual appropriations of approximately \$1.7 billion, which would be equivalent to interest on the unfunded accrued liability of approximately \$50.3 billion expected to exist as of June 30, 1967.

In comparison with the effect of our alternative approach, adoption of the Cabinet Committee recommendations would result in smaller increases in appropriations in the immediate future and larger increases in later years, the accumulation of a smaller balance in the Civil Service Retirement and Disability Fund, and a large increase in the amount of the unfunded accrued liability.

The Cabinet Committee recommendations would postpone indefinitely recognition in the administrative budget of some \$36 billion in future costs of the Civil Service Retirement System (measured by the difference between the amount of the unfunded accrued liability of about \$50.3 billion expected to exist as of June 30, 1967, and the amount of the unfunded accrued liability of approximately \$86 billion—the amount at which it would become stabilized in the year 2015 or thereabouts under the Cabinet Committee plan). The Cabinet Committee recommendations would also postpone recognition of other costs as they are incurred from the immediate future until later years.

We believe that, in furtherance of the objective of prudent management of the Government's financial affairs, a consistent method of financing the System should be established that will recognize and provide for all costs of maintaining the System from year to year as the costs are incurred. This objective would be attained under our alternative approach.

There are many approaches that can be taken to improve the financing of the Civil Service Retirement System, two of which are explained in this report. It is our view that, regardless of the approach the Congress may choose to follow, it is important that a definite plan be adopted to improve the financing of the System at an early date.

APPENDIX I

CIVIL SERVICE RETIREMENT AND DISABILITY FUND—OPERATING RECEIPTS AND DISBURSEMENTS AND BALANCE
IN THE FUND FOR THE FISCAL YEARS 1921-66

[Cents omitted, therefore details will not add to totals]

Fiscal year ended June 30	Receipts				Disbursements
	Salary deductions, voluntary contri- butions and serv- ice credit pay- ments	Government appropriations and/or agency contributions	Interest and profit on investments	Total receipts	Payments to retired em- ployees
1921-28	\$142,729,500		\$13,211,143	\$155,940,643	\$51,032,215
1929-35	208,291,396	\$145,450,000	57,360,736	411,102,133	185,158,325
1936-40	186,851,456	321,843,280	82,147,062	590,841,798	272,080,148
1941-45	926,000,895	671,241,799	214,024,652	1,811,267,346	351,846,148
1946-50	1,451,079,693	1,243,583,880	551,909,068	3,246,572,642	615,912,850
1951	374,872,990	307,117,455	164,561,022	846,551,467	185,421,904
1952	414,782,450	312,776,021	188,130,280	915,688,752	203,625,518
1953	420,034,454	325,304,154	214,609,442	959,948,051	246,711,418
1954	425,000,030	35,303,239	225,654,018	685,957,288	281,560,565
1955	440,284,878	33,678,729	234,377,235	708,340,843	310,280,639
1956	570,816,475	237,252,793	211,829,113	1,019,898,383	366,320,273
1957	640,522,470	530,632,662	220,793,978	1,391,949,112	425,645,499
1958	675,098,086	583,942,744	194,052,071	1,453,092,902	507,606,149
1959	761,722,957	754,129,236	219,749,314	1,735,601,507	601,050,915
1960	760,195,742	749,498,975	251,124,061	1,760,818,780	668,435,682
1961	855,640,591	890,192,793	281,633,944	2,027,467,328	736,741,184
1962	863,512,529	895,886,163	322,888,251	2,082,296,944	813,290,084
1963	933,943,173	950,852,817	362,290,266	2,247,086,257	914,105,941
1964	994,477,989	1,041,941,019	419,853,966	2,456,272,975	1,032,238,017
1965	1,066,846,060	1,115,356,476	482,170,944	2,664,373,481	1,126,017,513
1966	1,112,559,914	1,164,453,174	546,357,597	2,823,370,686	1,322,108,789
Total	14,225,263,737	12,310,447,418	5,458,728,173	31,994,439,329	11,217,189,785

Disbursements—Continued

Fiscal year ended June 30	Payments to survivor annuitants	Payments to refunds and death claims	Adminis- trative expense	Total dis- bursements	Transfers from (+) to (-) other retirement systems	Balance in fund June 30
1921-28		\$21,923,168		\$72,955,384		\$82,985,259
1929-35		35,731,558		220,889,883	-\$1,467,800	271,729,708
1936-40		37,366,674		309,446,822	-3,162	553,121,521
1941-45		136,235,709		488,081,858	-79,358	1,876,227,651
1946-50	\$8,387,864	679,574,736		1,303,875,451	+23,304,509	3,842,229,352
1951	10,897,666	72,534,135		268,853,707		4,419,927,112
1952	16,079,596	78,879,612		298,584,727		5,037,031,138
1953	23,472,466	91,023,429		361,207,314		5,635,771,876
1954	29,445,478	98,118,629		409,124,673		5,912,604,490
1955	34,858,748	82,655,739		427,795,126		6,193,150,207
1956	44,034,630	94,082,162		504,437,066		6,708,611,524
1957	53,021,114	109,522,080		588,188,694		7,512,371,942
1958	62,491,630	126,511,408		696,609,189		8,268,855,655
1959	84,501,208	106,063,345		791,615,469		9,212,841,693
1960	98,595,756	125,923,047		892,954,486		10,080,705,987
1961	111,198,621	115,071,522		963,011,328		11,145,161,987
1962	123,574,453	124,125,796		1,060,990,335		12,166,468,596
1963	141,051,575	120,610,355		1,175,767,871		13,237,786,982
1964	163,473,563	123,930,849		1,319,642,431		14,374,417,526
1965	181,532,265	130,119,909		1,437,669,688		15,601,121,319
1966	209,244,443	157,136,201	\$42,821	1,688,532,255		16,735,959,750
Total	1,395,861,085	2,667,140,073	42,821	15,280,233,766	+21,754,187	

APPENDIX II

CIVIL SERVICE RETIREMENT AND DISABILITY FUND, GOVERNMENT APPROPRIATIONS AND AGENCY CONTRIBUTIONS

[Cents omitted, therefore details will not add to totals]

Fiscal year ended June 30	Government appropriations	Agency contributions	Total Government appropriations and/or agency contributions
1921-28-----			
1929-35-----	\$145,450,000		\$145,450,000
1936-40-----	321,843,280		321,843,280
1941-45-----	671,241,799		671,241,799
1946-50-----	1,243,583,880		1,243,583,880
1951-----	307,117,455		307,117,455
1952-----	312,776,021		312,776,021
1953-----	325,304,154		325,304,154
1954-----	35,303,239		35,303,239
1955-----	33,678,729		33,678,729
1956-----	237,252,793		237,252,793
1957-----	530,632,662		530,632,662
1958-----		\$583,942,744	583,942,744
1959-----		754,129,236	754,129,236
1960-----		749,498,975	749,498,975
1961-----	46,329,000	843,863,793	890,192,793
1961-----	44,637,000	851,259,163	895,896,163
1963-----	30,000,000	920,852,817	950,852,817
1964-----	62,000,000	979,941,019	1,041,941,019
1965-----	65,000,000	1,050,356,476	1,115,356,476
1966-----	67,000,000	1,097,453,174	1,164,453,174
Total-----	4,479,150,021	7,831,297,397	12,310,447,418

APPENDIX III

ESTIMATED PROGRESS OF THE FUND, ASSUMING AGENCY CONTRIBUTIONS MATCHING EMPLOYEE DEDUCTIONS PLUS DIRECT APPROPRIATIONS SUFFICIENT TO MEET NORMAL COST AND INTEREST ON DEFICIENCY

[In millions of dollars]

Fiscal year ended June 30	Employee deductions ¹	Government payments		Interest at 3½ percent on investments	Total receipts	Benefit payments	Balance in fund at end of year
		Agency contributions	Direct appropriations				
1966-----							16,736
1967-----	1,155	1,140	273	594	2,962	1,945	17,753
1968-----	1,155	1,140	1,906	691	4,892	2,121	20,524
1969-----	1,155	1,140	1,906	785	4,986	2,278	23,232
1970-----	1,155	1,140	1,906	877	5,078	2,445	25,865
1971-----	1,155	1,140	1,906	966	5,167	2,618	28,414
1972-----	1,155	1,140	1,906	1,052	5,253	2,796	30,871
1973-----	1,155	1,140	1,906	1,135	5,336	2,977	33,230
1974-----	1,155	1,140	1,906	1,215	5,416	3,163	35,483
1975-----	1,155	1,140	1,906	1,290	5,491	3,354	37,620
1980-----	1,155	1,140	1,906	1,602	5,803	4,304	46,382
1985-----	1,155	1,140	1,906	1,805	6,006	5,118	51,969
1990-----	1,155	1,140	1,906	1,921	6,122	5,634	55,142
1995-----	1,155	1,140	1,906	1,986	6,187	5,913	56,909
2000-----	1,155	1,140	1,906	2,022	6,222	6,078	57,874
2005-----	1,155	1,140	1,906	2,042	6,243	6,180	58,442
2010-----	1,155	1,140	1,906	2,056	6,257	6,224	58,810
2015 and after-----	1,155	1,140	1,906	2,061	6,262	6,262	58,963

¹Includes service credit payments.²Special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and following years, presumption is made that requirement for special appropriations will be eliminated by legislative action.

APPENDIX IV

ESTIMATED PROGRESS OF THE FUND, ASSUMING AGENCY CONTRIBUTIONS MATCHING EMPLOYEE DEDUCTIONS PLUS DIRECT APPROPRIATIONS WHEN NEEDED TO MEET BENEFIT PAYMENTS

[In millions of dollars]

Fiscal year ended June 30	Employee deductions ¹	Government payments		Interest at 3½ percent on invest- ments	Benefit payments	Balance in fund at end of year
		Agency con- tributions	Direct appro- priations			
1966						16,736
1967	1,155	1,140	* 73	594	1,945	17,753
1968	1,155	1,140		624	2,121	18,551
1969	1,155	1,140		650	2,278	19,218
1970	1,155	1,140		670	2,445	17,738
1971	1,155	1,140		685	2,618	20,100
1972	1,155	1,140		695	2,796	20,294
1973	1,155	1,140		698	2,977	20,310
1974	1,155	1,140		696	3,163	20,138
1975	1,155	1,140		686	3,354	19,765
1980	1,155	1,140		528	4,304	14,589
1985	1,155	1,140		171	5,118	3,642
1990	1,155	1,140	3,339		5,634	(²)
1995	1,155	1,140	3,618		5,913	
2000	1,155	1,140	3,783		6,078	
2005	1,155	1,140	3,885		6,180	
2010	1,155	1,140	3,929		6,224	
2015 and after	1,155	1,140	3,967		6,262	

¹ Includes service credit payments.² Special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and subsequent years, presumption is made that requirement for special appropriations to continue benefits provided by Public Law 87-793 will be eliminated by legislative action.³ Fund would be exhausted in 1987.

APPENDIX V

U.S. CIVIL SERVICE COMMISSION,
Washington, D.C., February 23, 1967.

Mr. PHILIP CHARAM,
Associate Director, Civil Accounting and Auditing Division,
U.S. General Accounting Office,
Washington, D.C.

DEAR MR. CHARAM: I appreciate the opportunity to review the draft of the proposed General Accounting Office report to Congress on financing the Civil Service Retirement System.

We concur without reservation in your belief that an adequate and consistent method of financing the System should be established.

We agree, also, that normal costs should be fully funded, and on a current basis. We would prefer, however, to see this funding accomplished through employee and agency contributions rather than through establishment of an additional annual appropriations requirement over and beyond those contributions. The present method of using agency contributions plus deductions from employees' salaries to meet normal retirement costs is already well established and well understood. It is simple, efficient, and highly effective. We should like to preserve those advantages by extending the same method (adjusted, if necessary, to reflect a different cost-sharing ratio) to cover the full normal cost of the System.

The proposed permanent indefinite appropriation procedure is a good approach to controlling growth of the unfunded liability. Rather than employ the procedure to produce amounts equivalent to the annual interest on the unfunded liability, however, I would suggest that it be used to maintain the Fund balance at its peak or at employee equity, whichever is greater. If this were done, confidence in the integrity of the Fund would be assured (because the balance would never drop and there would always be in the Fund an amount at least equal to that contributed by employees and former employees and still remaining to their credit); there would be no excessive build-up of the balance in advance of actual need for the money; yet availability of sufficient funds to assure prompt and full payment of benefits, without awaiting appropriation action to permit payments already due, would be assured.

We believe that comment on considering the unfunded liability as part of the public debt, but exempting it from the ceiling, should come from the Secretary of the Treasury since he is the official who by law is responsible for management of both the public debt and the retirement fund.

We agree that it is desirable that definite and timely provisions be made to cover future increases in the unfunded liability whenever such an increase is created. Annual appropriations to amortize such increases over a specified period of time are acceptable for that purpose, though we see no particular advantage to a 20-year as compared with a 30-year table as the mechanism for amortization.

Thank you for the opportunity to comment on the draft. There are many methods by which the problem of improved financing could be approached, and each undoubtedly has its advantages and disadvantages. From our point of view, the precise method adopted is less important than getting started, in any reasonable fashion, on some definite program of increasing contributions to the Fund.

Sincerely yours,

JOHN W. MACY, Jr., *Chairman.*

APPENDIX VI

TREASURY DEPARTMENT,
Washington, D.C., February 8, 1967.

Mr. MAX A. NEUWIRTH,
Assistant Director, U.S. General Accounting Office,
Washington, D.C.

DEAR MR. NEUWIRTH: This is in reply to your letter of January 19, 1967, requesting comments on a draft of your proposed report to the Congress on financing the Civil Service Retirement System.

In reviewing your draft report we have compared the report's financing recommendations with those of the Cabinet Committee on Federal Staff Retirement Systems as well as with the current financing practice. The spectrum of retirement system financing ranges from full funding in the strict sense of the word at one extreme to pay as you go at the other extreme. Your recommendations and those of the Cabinet Committee call for partial funding at different levels within this financing spectrum. The existing policy of modified pay as you go lies nearer the bottom end of the spectrum.

Assuming static conditions, the table below compares projections of the System under the three financing methods referred to above. This material is taken directly from Appendices III and IV of your report except for the Cabinet Committee method which has been computed roughly on the basis of the same benefit and contribution figures contained in the other two projections.

Fiscal year	General Accounting Office proposal		Cabinet committee proposal		Existing financing		Employee equity
	Direct appropria- tion	Fund	Direct appropria- tion	Fund	Direct appropria- tion	Fund	
1967-----	\$0.1	\$17.8	\$0.1	\$17.8	\$0.1	\$17.8	\$9.8
1970-----	1.9	25.9	-----	20.2	-----	19.7	11.3
1975-----	1.9	37.6	.2	21.2	-----	19.8	13.4
1980-----	1.9	46.4	1.1	21.2	-----	14.6	15.0
1985-----	1.9	52.0	1.9	21.2	-----	3.6	15.8
1990-----	1.9	55.1	2.4	21.2	3.3	-----	16.1
1995-----	1.9	56.9	2.7	21.2	3.6	-----	16.1
2000-----	1.9	57.9	2.9	21.2	3.8	-----	16.1
2005-----	1.9	58.4	3.0	21.2	3.9	-----	16.1
2010-----	1.9	58.8	3.0	21.2	3.9	-----	16.1
2015-----	1.9	59.0	3.0	21.2	4.0	-----	16.1
2020-----	1.9	59.0	3.0	21.2	4.0	-----	16.1
2025-----	1.9	59.0	3.0	21.2	4.0	-----	16.1
2030 and after...	1.9	59.0	3.0	21.2	4.0	-----	16.1

In each method the annual appropriation and the fund ultimately level off. In each case the unfunded liability will become stabilized. That is, all (or almost all) of the ultimate level appropriation in each case represents annual interest on an unfunded liability which complements the ultimate fund.

By systematic annual appropriations beginning immediately the GAO proposal would in effect peg the fund at \$59.0 billion. The Cabinet Committee pro-

posals, by gradually increasing appropriations, would peg the fund at \$21.2 billion. The current basis, of course, would peg the fund at zero. Certainly a great deal can be said for maintaining a fund equal to or greater than the employee equity. Either the GAO proposal or the Cabinet Committee proposal would accomplish this. Aside from this or similar requirements it would seem that the determination of which system of partial funding is more desirable would depend upon the practical effect of one stream of appropriations as against another or one level of the fund as against another.

Turning from static assumptions to dynamic and expanding assumptions, it is expected that as time goes on the present unfunded liability will become less important relative to the future increments in liability. Under these conditions we could consider the desirability of amortizing future increments in 20 years under the General Accounting Office proposal as against 30 years under the Cabinet Committee proposal. Here again, the difference is a matter of degree.

The Treasury Department supports the financing provisions contained in the Cabinet Committee's report which was endorsed by the President in his letter of transmittal to the Congress dated March 7, 1966.

The Treasury Department would be particularly opposed to your recommendation to amend the Second Liberty Bond Act to consider the amount of the unfunded accrued liability as a part of the public debt. Even though such amount would not be counted against the public debt limitation we believe that consideration of its inclusion in the public debt for this purpose would establish an undesirable and dangerous precedent. Annual appropriations made under permanent indefinite authorization would, in our opinion, be the more desirable method.

Sincerely yours,

JOHN K. CARLOCK,
Fiscal Assistant Secretary.

APPENDIX VII

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., February 22, 1967.

Mr. PHILIP CHARAM,
*Associate Director, Civil Accounting and Auditing Division,
General Accounting Office,
Washington, D.C.*

DEAR MR. CHARAM: In response to your request of January 19, 1967, we offer the following comments on your draft report entitled, "Financing the Civil Service Retirement System." The report makes the following recommendations:

1. Annual appropriations should be made to cover the excess of the normal cost of the Civil Service Retirement System (13.60% of payroll) over the amounts provided by agency and employee contributions (currently 13.0%).
2. Annual appropriations should be made to cover interest on the unfunded accrued liability of the system (currently estimated at approximately \$1700 million).
3. Appropriations should be made to amortize over a reasonable period, preferably 20 years, any future incremental unfunded liability resulting from benefit liberalizations, pay increases, or extensions of coverage to new groups of employees.
4. Actuarial valuations of the Civil Service Retirement System should be made more frequently than every five years.

As the report points out, there has been a wide variety of approaches to financing the Civil Service Retirement System since its establishment in 1920. Furthermore, a number of studies, both formal and informal, have been made over the intervening years, resulting in recommendations for improving the financing of the system.

The most recent study was that of the Cabinet Committee on Federal Staff Retirement Systems which was submitted to the President on February 15, 1966, and transmitted with his endorsement to the Congress on March 7, 1966.

The cabinet committee's recommendations differ from those of the Comptroller General's report in the following respects:

1. It recommends that "normal cost" of the system should be fully covered by combined agency and employee contributions.

Enactment of improvements in the system recommended by the committee would have the effect of raising "normal cost" to approximately 14.5 percent of payroll. The committee proposed that this be fully covered by increasing employee contributions to 7.0 percent and agency contributions to 7.5 percent.

By contrast the GAO report recommends annual appropriations in addition to current agency and employee contributions to cover normal costs in excess of the current contribution rate of 13.0 percent.

2. The GAO report recommends that direct appropriations begin immediately to fully cover interest on the current unfunded liability. The cabinet committee report recommends that direct appropriations for this purpose be deferred until they become necessary to maintain a specified reserve.

More specifically, the cabinet committee recommends that "direct appropriations under permanent indefinite authority should be made in amounts sufficient to peg the fund balance at whatever maximum level it might attain under this recommendation or at employee equity, whichever is the greater." Employee equity is defined as the total of active employee contributions, contributions of employees separated with vested rights, and beneficiary contributions net of benefits paid in their behalf.

The cabinet committee considered but discarded the proposal to begin immediately direct appropriations in amounts sufficient to fully cover interest as well as several variants involving schedules of increasing payment gradually rising to the amount needed to fully cover interest over a period of possibly 25 years.

Considerations which led to its final recommendations were these:

a. The fact that Federal staff retirement systems are backed by the full faith and credit of the United States is generally accepted as assurance that all future benefit payments will be met.

b. Annual direct appropriations of the amount needed to cover interest on the current unfunded liability would have a serious impact on the administrative budget of the United States. The necessary funds would have to be obtained either by increased taxes or by an increase in the budget deficit, and the latter would be reflected as an increase in the public debt.

Federal revenues and expenditures represent a large element of the national economy and have become an instrument for implementing public economic policy. The levels of Federal expenditures and revenues have a decided influence on the state of the economy. If taxes are raised there can be an adverse effect, particularly during periods when the economy is operating below its potential. Increased taxes in such circumstances will reduce consumer and business demand which, in turn, will tend to result in unemployment.

On the other hand, if appropriations are made to finance the retirement system without raising taxes, the budget deficit will be greater and the public debt will rise.

In summary, appropriations now to cover interest on the unfunded liability would result in an increase in the public debt held by the trust fund. This would be accompanied by either (1) a decrease in the public debt held by the public, if the taxes are increased, or (2) an increase in the total public debt if taxes are not increased.

Admittedly failure to arrest the growth of the unfunded liability will ultimately require larger direct appropriations than those currently proposed. However, when that time is reached (possibly 25 years from now), the moneys will be expended in the same year as they are appropriated thus having a neutral effect on the economy.

All things considered, the cabinet committee decided that it would be unwise to build up a huge balance in the retirement fund—and pay interest on it—at the cost of seriously reducing flexibility in budget programming for years to come.

c. An important objective of any plan for improving the financing of the retirement system is the provision of a more accurate measure of the true cost of the system. The cabinet committee report stressed the importance fulfilling this requirement.

The recommendations of the GAO report would accomplish this objective—but with the attendant disadvantage cited above.

3. The cabinet committee report also recommends that the cost of future incremental unfunded liability resulting from benefit liberalizations, pay increases, etc., be covered by annual direct appropriations.

However, instead of the level payment, 20-year amortization plan proposed by the GAO report, the obligation would be met by a 30-installments, increasing-payment amortization schedule.

The advantage of the latter method lies in the fact that amounts of the annual appropriations coincide more nearly with the actual payout of benefits and avoid the adverse effects noted above of large fund accumulations in the earlier years.

I believe that the recommendations of the cabinet committee would effectively meet this objective. The mechanics of the recommendation require full disclosure of retirement costs and explicitly allocate responsibility for such costs to (1) employees and agencies jointly, (2) agencies only, and (3) Government, as distinct from agencies. Normal cost would be completely covered; the cost of future incremental unfunded liability would be immediately acknowledged and a specific schedule for its amortization enacted into law; the balance in the fund would be pegged at a level that would insure the payment of future benefits into perpetuity; and maximum flexibility in the use of the budget as a tool of economic policy would be maintained.

With respect to the recommendation that actuarial valuation of the retirement system be more frequent than quinquennially, I would defer to the Chairman of the Civil Service Commission.

Sincerely,

PHILLIP S. HUGHES, *Acting Director.*

Mr. DANIELS. The subcommittee is pleased to welcome the testimony of the former Deputy Director of the Bureau of the Budget, now the Comptroller General of the United States, the Honorable Elmer B. Staats and accompanying representatives of the General Accounting Office.

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES, ACCOMPANIED BY GREGORY J. AHART, DEPUTY DIRECTOR, CIVIL DIVISION; FREDERIC H. SMITH, DEPUTY DIRECTOR, OFFICE OF POLICY AND SPECIAL STUDIES; AND JOHN C. FENTON, ASSISTANT DIRECTOR, CIVIL DIVISION, GENERAL ACCOUNTING OFFICE

Mr. STAATS. Thank you very much, Mr. Chairman.

I would like to introduce my colleagues here at the table with me. Fred Smith at my left here is the Deputy Director of our Office of Policy and Special Studies.

Mr. Ahart on my immediate right is Deputy Director of our Civil Division.

Mr. Fenton, to his right, has been concerned with this particular problem within the GAO for quite some time and he is one of our experts in this field.

I appreciate your invitation to present my views on H.R. 10912 which would provide for improved financing of the civil service retirement system. I feel strongly that, in furtherance of the objective of prudent management of the Government's financial affairs, it is important that the Congress provide a definite plan to improve the system's financing.

At June 30, 1967, the civil service retirement system was expected to have an unfunded accrued liability of about \$50 billion, assuming that restrictions on the payment of certain benefits, imposed by the Independent Offices Appropriation Act, 1959 (5 U.S.C. 8348(g)), will be removed. Otherwise, the unfunded accrued liability was expected to be about \$48 billion. Under the present method of financing, the unfunded accrued liability—that is, the accumulated costs of the system for which funds have not been provided—will continue to grow by at least \$1.7 billion each year.

By 1974, the annual benefit payments will exceed the annual receipts of the fund; by 1980, the balance in the fund will be less than employee equity; and, by 1987, the balance, which amounted to \$17.8 billion at June 30, 1967, will be completely exhausted unless the present method of financing is improved.

Many factors have contributed to the existence and growth of this unfunded liability. Employees were given credit for service rendered prior to the establishment of the civil service retirement system in 1920. No contributions were made to the fund for this past service by either the employees or the Government. Also, in early years no appropriations were made either to cover the normal cost based on current service or to reduce the unfunded accrued liability based on prior service and in some years when appropriations were made they were less than the normal cost. Allowing credit for periods of military service increased the unfunded liability. And the liability has grown as a result of increases in the level of benefit payments and increases in salary rates.

The unfunded accrued liability has grown also because funds provided under the matching formula adopted in 1956 have not been sufficient to fully cover the normal cost of the system and because the fund is not receiving interest on the unfunded accrued liability.

Since July 1, 1957, the civil service retirement system has been financed principally by deductions of 6½ percent from employees' salaries, by matching contributions from employing agencies, and by interest income received on fund investments. The amounts provided from these sources are not sufficient to cover the full annual cost of the system.

The following additional amounts would have to be paid or contributed to the fund to cover the full annual cost.

1. The excess of the normal cost of the system over the amounts provided by agency contributions and deductions from employees' salaries.

2. Interest on the unfunded accrued liability.

3. The amount of any future increase in the unfunded accrued liability.

The provisions of H.R. 10912 were designed to carry out most of the proposals for improving the financing of the civil service retirement system contained in the report of the Cabinet Committee on Federal Staff Retirement Systems. That report, prepared in response to a request of the President of the United States for a review of Federal policies and benefits and printed in House Document 402, 89th Congress, was submitted by the President to the Congress in March 1966 with the recommendation that financing provisions be enacted as part of the retirement legislation.

The provisions of H.R. 10912 for financing the civil service retirement system call for—

1. Deductions from employees' salaries and contributions by employing agencies to be made in equal amounts to cover the full normal cost of the civil service retirement system.

2. Direct appropriations to the civil service retirement and disability fund sufficient to amortize over a 30-year period in progressively increasing amounts increases in the unfunded accrued liability arising from future legislation, except those arising from cost-of-living adjustments.

3. Direct appropriations under permanent indefinite authority in amounts sufficient to ultimately peg the fund balance at a specified level equal to or in excess of employees' equity and to ultimately stabilize the existing unfunded accrued liability.

In April 1967, the General Accounting Office submitted a report to the Congress outlining an alternative approach to that proposed by the Cabinet Committee for financing the civil service retirement system. Our proposed alternative approach would provide for—

1. Deduction from employees' salaries and contributions by employing agencies to be made in such proportions as considered desirable by the Congress, which may be other than equal amounts, sufficient to cover the full normal cost of the system, with the cost-sharing ratio as determined by the Congress to be enacted into law.

2. Direct appropriations to the civil service retirement and disability fund sufficient to amortize in equal annual amounts over a 20-year period all future increments in the unfunded accrued liability.

3. Direct appropriations to the civil service retirement and disability fund under permanent indefinite authority in annual amounts equivalent to interest on the total unfunded accrued liability.

The financing provisions of H.R. 10912 and our alternative approach differ with respect to—

The method for determining the proportion of normal cost to be contributed by the agencies and the proportion to be deducted from employees' salaries;

The period and the level at which appropriations would be made to amortize future increments in the unfunded accrued liability; and

The amount of the additional appropriations required to peg the fund balance at a specified level in one case and to provide for amounts equivalent to interest on the unfunded accrued liability in the other.

The last two differences would result in differences in the size of the fund balances that would be accumulated, differences in the level at which the existing unfunded accrued liability would become stabilized, and differences in the length of time required for it to become stabilized. They would result also in differences in the amounts of expenditures to be recognized in the Government's administrative budget each year and, consequently, in differences in the amount of the budget deficits or surplus.

Both H.R. 10912 and our alternative approach would provide for covering normal cost in full. H.R. 10912 would provide for equal sharing of normal cost by employees and employing agencies. It would authorize and require the Civil Service Commission to adjust the percentage to be deducted from employees' salaries and the amount to be contributed by the agencies as necessary to meet full normal cost. Although the Cabinet Committee had recommended that normal cost be covered in full, it did not specify by what mechanism such adjustments would be made. Also, the Cabinet Committee recommended that the full normal cost of future changes in the civil service retirement system designed to improve management be covered solely by agency

contributions. This recommendation has not been incorporated in H.R. 10912.

Under our alternative approach we have suggested that the Congress may wish to consider covering the full normal cost of the system through deductions from employees' salaries and agency contributions in proportions which may be other than equal proportions and setting forth in law the specific cost-sharing ratio to be followed.

Mr. DANIELS. At this point, do you feel that the ratio should be different from the present method of sharing which is on a 50-50 basis? Do you recommend to this committee that—

Mr. STAATS. We do not feel, Mr. Chairman, that it necessarily follows that the employee contribution needs to be as large as the Government's contribution. We do feel that the principle of sharing is a desirable principle but we do not feel it should necessarily be tied to 50-50 sharing. We say this for several reasons: One is that the interest rate earned by the fund is less than could be earned if it were privately invested. Secondly, the trend in private industry and in other retirement systems has been in the direction of a larger proportion of the cost being borne by the employer rather than the employee.

Having said that, I do think it is important that we emphasize that the Government's contribution to retirement benefits is one part of a total package of fringe benefits and also a part of the total compensation. It should be evaluated and considered in relationship to the pay levels which are provided to the employees.

Mr. DANIELS. Has your office made such an evaluation?

Mr. STAATS. An evaluation of—

Mr. DANIELS. Of the fringe benefits.

Mr. STAATS. We have not, but the Bureau of Labor Statistics has made such an evaluation. They are currently in the process of bringing that study, which was a 1963 study, up to date. I talked with the head of the BLS just the other day and he hopes to have this information available very shortly. This information is available although we have not made a separate study of it in our office.

Mr. DANIELS. Inasmuch as no appropriations have been made for the unfunded liability, if need be made, interest would be drawn on that account; is that correct?

Mr. STAATS. We are so recommending.

Mr. DANIELS. If it were fully funded, under existing law those moneys would have to be invested in Government bonds or securities?

Mr. STAATS. That is correct.

Mr. DANIELS. If we were to invest those funds in other than Government bonds and securities, then it would be necessary to change the present law?

Mr. STAATS. Right. We are not suggesting that that law be changed. We are simply suggesting that the ratio of employee-employer contribution might take into account the fact that that law is on the statute books and that there is a requirement that these funds be invested in Government securities which at the moment at least are earning less money than could be earned outside.

This has a bearing on what total normal cost amounts to because the calculation of normal cost gives effect to the interest factor.

Mr. DANIELS. Have any studies been made by your office of the amount of contributions made by private industry?

Mr. STAATS. This varies a great deal.

The trend on this has been set forth most recently in a study made by the Bureau of Labor Statistics called "Private Pension Plan Benefits." It is their Bulletin No. 1485 and it is dated June 1966. It has a great deal of information bearing on recent trends in private industry and one of the statements which is included in this report, for example, is that employers finance the entire costs of retirement benefits in about three out of four plans and that these noncontributory plans cover the same proportion of workers. In other words, an overall review of the plans in private industry would indicate that in about 75 percent of these plans they were noncontributory. The employer picked it all up. The considerations in private industry are somewhat different than in Government because in private industry the employer picks his costs up as part of his operating costs and hence this affects his tax levels.

The trend has been in this direction, I believe, also in State and local governments, recognizing that in the sharing here the employer bears a somewhat larger burden than the employee.

Mr. DANIELS. Go ahead.

Mr. STAATS. With respect to financing future increases in the unfunded accrued liability, H.R. 10912 would provide for gradual liquidation of any such increases arising from future legislation, except increases attributable to cost-of-living adjustments. Liquidation would be accomplished by direct appropriations to be made to the civil service retirement and disability fund over 30-year periods in progressively increasing amounts. To illustrate the effect of making appropriations in progressively increasing amounts, the appropriation in the 30th year would be 30 times as large as the appropriation in the first year. Under our alternative approach, all future increases in the unfunded accrued liability would be liquidated by direct appropriations over 20-year periods in equal annual amounts.

In addition to providing for financing to cover normal cost in full and to gradually liquidate certain future increases in the unfunded accrued liability, H.R. 10912 would provide for additional financing through annual Government contributions. Those contributions would be made under permanent indefinite authority, in such amounts as would be necessary to make the fund balance at the end of any fiscal year equal to employee equity at that date or equal to the fund balance at the end of the preceding fiscal year, whichever would be the greater.

On the basis of present benefit and pay levels, these contributions would be expected to begin in fiscal year 1975 with an appropriation of approximately \$200 million, and would gradually increase, ultimately resulting in annual appropriations of about \$3 billion. At that time, the appropriation would be equivalent to interest on the unfunded accrued liability, which would grow to about \$86 billion.

Under our alternative proposal, additional financing would be provided through direct appropriations under permanent indefinite authority in annual amounts equivalent to interest on the unfunded accrued liability existing at such time as the plan might be adopted. These annual appropriations would amount to approximately \$1.7

billion on the unfunded accrued liability of \$50 billion expected to exist as of June 30, 1967.

Both H.R. 10912 and our alternative proposals would stabilize the unfunded accrued liability. However, under H.R. 10912, it would not become stabilized until the year 2015 or thereabouts, and then only after the accrued liability had reached approximately \$86 billion, whereas under our alternative proposals it would become stabilized immediately at about \$50 billion.

The balance in the civil service retirement and disability fund would be expected to reach and to become stabilized at approximately \$21 billion under the provisions of H.R. 10912, and would be expected to reach and to become stabilized at approximately \$59 billion under our alternative approach.

No discussion of the effect of one method of providing additional financing in comparison with another method would be complete, however, if consideration were given only to the amount of the increased direct appropriations required under each method. Differences in the amounts of interest earned on fund investments, all of which is received from Government appropriations, also must be taken into account. Consequently, we have prepared tables, based on Civil Service Commission estimates, showing the amount of the direct appropriations and the amount of the interest that would be earned on fund investment under the provisions of H.R. 10912 and under our alternative approach. These tables, copies of which are attached to this statement, show that ultimately a total of \$3.8 billion in direct appropriations and interest on fund investments will be required each year, in addition to the deductions from employees' salaries and the contributions from employing agencies, to meet the benefit payments that will become due under present benefit levels.

To summarize, in comparison with the effect of our alternative approach, adoption of the provisions of H.R. 10912 would result in smaller increases in appropriations in the immediate future and larger increases in later years, the accumulation of a smaller balance in the civil service retirement and disability fund, and a large increase in the amount of the unfunded accrued liability.

The provisions of H.R. 10912 would postpone indefinitely recognition in the Government's administrative budget of some \$36 billion in future costs of the civil service retirement system, measured by the difference between the amount of the unfunded accrued liability of about \$50 billion expected to exist as of June 30, 1967, and the amount of the unfunded accrued liability of approximately \$86 billion—the amount at which it would become stabilized in the year 2015 or thereabouts under the provisions of H.R. 10912. H.R. 10912 would also postpone recognition of other costs as they are incurred from the immediate future until later years.

Our alternative approach would have the advantage of providing a consistent method of financing the system that recognizes and provides for all costs of maintaining the system from year to year as the costs are incurred.

There are many approaches that can be taken to improve the financing of the civil service retirement system in addition to the two discussed herein.

You will recall in 1963 there was still a different approach submitted which this committee held hearings on.

It is my view that, regardless of the method of Congress may choose, it is important that a definite plan be adopted to improve the financing of the system at an early date.

I would like to add here, Mr. Chairman, that I commend this committee for these hearings. This is a matter that I have been concerned about for a good many years. I am afraid this is a matter on which we have just postponed and postponed and postponed the issue. It is not going to be long until this is going to be a very critical situation if we do not do something about it now. The longer we postpone it, the more difficult the solution becomes.

Both the Cabinet Committee recommendations and H. R. 10912 provide for merging the civil service retirement and disability fund and the Foreign Service retirement and disability fund.

We in the GAO have not dealt with this problem separately and we have no opinion to express as to its merits.

It is pertinent to consider the effect that adoption of the recommendations contained in the recently issued report of the President's Commission on Budget Concepts might have on the desirability of adopting the provisions of H.R. 10912 or our alternative proposals.

Mr DANIELS. We would appreciate it if you would submit copies of that to the committee.

Mr. STAATS. Yes, sir.

Inasmuch as the recommendations of the President's Commission relate to the form in which the budget is to be presented rather than to methods of financing, their adoption would not diminish the desirability of adopting a definite plan to improve the financing of the civil service retirement system at an early date.

Adoption of the recommendations of the President's Commission would, however, make it possible to make lump-sum appropriations to the civil service retirement and disability fund to completely eliminate the existing unfunded accrued liability and to cover any future increases in the accrued liability resulting from increases in benefit levels, salary rates, etc., without such appropriations having any effect on the reported budget deficit. Adoption of the recommendations of the President's Commission would also make it possible to increase agency contributions to the fund under any plan that might be adopted to cover normal cost in full without such increased contributions having any effect on the reported budget deficit.

Such appropriations and transfers would not be included in determining the amount of the budget deficit because they represent transfers between the general fund of the Treasury or the agency appropriation accounts and the civil service retirement and disability fund and because the unified budget recommended by the President's Commission entails the elimination of all intragovernmental transactions among different funds and agencies included in the budget.

The President's Commission expressed the hope that the definition of the public debt subject to limit can be set up in a manner consistent with its recommendations that, in presenting figures on Federal borrowing, Federal securities held by Federal agencies and trust funds

be shown separately from Federal securities held by the public. Under this concept, the debt limit would apply only to Federal securities held by the public. Under these conditions, Federal securities purchased by the civil service retirement and disability fund with funds obtained as a result of the additional appropriations and contributions would not be subject to the debt limit.

If the chairman or members of the subcommittee have any questions, I will be pleased to answer them. We realize that your time is limited this morning but I would like to emphasize in concluding that our purpose in outlining the alternative approach here today is not so much to express disagreement or differences with the executive branch proposal but rather to outline an alternative approach which we feel might have advantages for the consideration of this committee.

We are, as you know, an agency of the legislative branch and I am an officer of the legislative branch and it has been my feeling that the more we can offer alternatives to the Congress for its consideration, which we think merit its consideration, the better we are going to be serving the Congress. Here is a case in point where we believe that we have presented some realistic alternatives. We think they may have some advantages over the alternatives presented in H.R. 10912.

Whichever way the Congress goes, we simply want to emphasize that we think that this is a serious matter. We think it is very important and we think it is a matter of great concern to all employees of the Federal service, and affects our ability to hire employees in the future.

Mr. DANIELS. Mr. Comptroller, I want to compliment you on a very forthright and frank statement this morning.

(The tabulation accompanying Mr. Staats' statement follows:)

EFFECT OF PROVISION IN H.R. 10912 TO PEG FUND BALANCE¹

[In billions of dollars]

	Direct appropriations	Interest on fund investments	Total direct appropriations and interest	Fund balance at end of year	Unfunded accrued liability
1966				16.7	44.0
1967	² 0.1	0.6	0.7	17.8	³ 50.3
1968		.6	.6	18.7	
1969		.7	.7	19.5	
1970		.7	.7	20.2	
1975	.2	.7	.9	21.2	
1980	1.1	.8	1.9	21.2	
1985	1.9	.8	2.7	21.2	
1990	2.4	.8	3.2	21.2	
1995	2.7	.8	3.5	21.2	
2000	2.9	.8	3.7	21.2	
2005	3.0	.8	3.8	21.2	
2010	3.0	.8	3.8	21.2	
2015 and after	3.0	.8	3.8	21.2	⁴ 86.0

¹ These tables are based on benefit levels and other factors expected to exist as of June 30, 1967, including the effect of all legislation enacted through the 89th Cong.

² The direct appropriation of \$100,000,000 in fiscal year 1967 represents the special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and subsequent fiscal years, a presumption was made that the requirement for special appropriations would be eliminated by legislative action.

³ The unfunded accrued liability of \$50,300,000,000 expected to exist as of June 30, 1967, includes an amount of approximately \$2,200,000,000 relating to increased benefits provided by Public Law 87-793. This amount was included on the assumption that the requirement for special appropriations would be eliminated.

⁴ Under the provision in H.R. 10912, the unfunded accrued liability would increase each year until it reached a peak of approximately \$36,000,000,000 in the year 2015 or thereabouts. It would then become stabilized at that amount.

EFFECT OF GAO's APPROACH UNDER WHICH DIRECT APPROPRIATIONS WOULD BE MADE IN AMOUNTS
EQUIVALENT TO INTEREST ON THE UNFUNDED ACCRUED LIABILITY¹

[In billions of dollars]

	Direct appro- priations	Interest on fund invest- ments	Total direct appropriations and interest	Fund balance at end of year	Unfunded accrued liability
1966				16.7	44.0
1967	² 0.1	0.6	0.7	17.8	\$ 50.3
1968	1.7	.7	2.4	20.5	50.3
1969	1.7	.8	2.5	23.2	50.3
1970	1.7	.9	2.6	25.9	50.3
1975	1.7	1.3	3.0	37.6	50.3
1980	1.7	1.6	3.3	46.4	50.3
1985	1.7	1.8	3.5	52.0	50.3
1990	1.7	1.9	3.6	55.1	50.3
1995	1.7	2.0	3.7	56.9	50.3
2000	1.7	2.0	3.7	57.9	50.3
2005	1.7	2.0	3.7	58.4	50.3
2010	1.7	2.1	3.8	58.8	50.3
2015 and after	1.7	2.1	3.8	59.0	50.3

¹ These tables are based on benefit levels and other factors expected to exist as of June 30, 1967, including the effect of all legislation enacted through the 89th Congress.

² The direct appropriation of \$100,000,000 in fiscal year 1967 represents the special appropriation required to continue benefits provided by Public Law 87-793. For 1968 and subsequent fiscal years, a presumption was made that the requirement for special appropriations would be eliminated by legislative action.

³ The unfunded accrued liability of \$50,300,000,000 expected to exist as of June 30, 1967, includes an amount of approximately \$2,200,000,000 relating to increased benefits provided by Public Law 87-793. This amount was included on the assumption that the requirement for special appropriations would be eliminated.

Mr. DANIELS. I realize that this is a very involved and complicated matter. I am frank enough to admit that, as the chairman of this subcommittee on which I have been serving for the past 3 years, this is a new field and new territory for me.

I have a lot of homework to do and I am quite sure my colleagues on this committee, more or less, feel that they are in the same position.

It is indeed refreshing to have you come here this morning to represent one of our governmental agencies and give a point of view which varies from that of the other officials who previously testified—the Chairman of the Civil Service Commission, Mr. Macy, and Mr. Hughes who appeared on behalf of Director Charles Schultze, of the Bureau of the Budget.

What caused me a great deal of concern in connection with the testimony of Mr. Schultze and Chairman Macy was the fact that no attempt would be made under their proposal to finance the present unfunded liability. I note in your testimony that you do go into that subject.

Another major point of difference also is that under the schedule with respect to financing any future liability that would be incurred, they take a 30-year period of time; whereas you would stretch it out for a lesser period of time. Your payments cover a 20-year period of time and there would be a certain constant payment each year; whereas their recommendation starts off with a small sum and progressively growing larger and larger until you get to the point, I think you said \$3,800 million would be required?

Mr. STAATS. The payment would grow progressively larger until the increase in the unfunded liability is fully amortized.

Mr. DANIELS. Thirty years from now?

Mr. STAATS. Yes, sir.

Mr. DANIELS. These are major differences.

Mr. STAATS. If I could interrupt, Mr. Chairman, one of the practical difficulties of what is called the arithmetic progression approach out-

lined in H.R. 10912 is that the longer you go, the more difficult it becomes to obtain necessary appropriations. We think it would be more realistic to start out with the assumption that you are going to pay off the increase but pay it off in level amounts. This is the way we treat the normal costs in the budget.

Six and a half percent was fixed to represent a level premium in the same way an insurance policy does. We feel that the principle here of having a level payment rather than a graduated payment is better and we think politically a more realistic approach to the problem.

Mr. DANIELS. I would like to have your comment on this observation: There apparently is an inconsistency in the testimony of previous witnesses in which they state that the full faith and credit of the United States is pledged behind the payment of these benefits to our employees now and those who might be engaged in the future, and, therefore, it is unnecessary to fund the present unfunded liability. With respect to increases in this liability, then we set up a program whereby appropriations would be made annually. I would like to have your comment on that.

Mr. STAATS. I would be very happy to comment on that. As a matter of fact, I have very definite feelings about that. There is no question about it, that the full faith and credit lies behind the Government commitment to meet our retirement benefits, but the difficulty with that is that this argument simply goes to the question of whether or not these benefits will be paid. It does not go to the question of whether this is a sound way to do it.

If you follow the argument of full faith and credit logically to its conclusion, you would wash out all of the fund; you would just go ahead as we are now and pretty soon you would not have any fund left and you would be paying out on a pay-as-you-go basis. That is the logical extension of that argument. There would be no point in pegging it at any particular level.

One point that has been made is that perhaps you could peg it at the level which represents the employee's equity in the fund on the ground he has made that contribution and it is his property. You could carry it to that point, but the argument for full faith and credit overlooks, it seems to me, an orderly system for financing a retirement system that the Federal Government establishes to meet its responsibilities as an employer. This means that you take orderly steps to finance it and you calculate your benefits, as well as any liberalization of those benefits, in terms of what it is going to cost you, not in terms of the immediate budget year, but in terms of the long-term costs. We have had a lot of discussion over the years about disclosure of total costs in the budget. This has been particularly true since there has been discussion of the planning, programing, and budgeting system. The full faith and credit argument seems to me to go in the opposite direction. To be sure, you could make the calculation. It is one thing to make a calculation and another thing to face up to the responsibility of appropriating the money. That seems to me to be the important consideration here.

Mr. DANIELS. As I said, full faith and credit is pledged as far as the present unfunded liability is concerned, but then we drop the full faith and credit with respect to the future liabilities. In that respect I say there is an inconsistency in their argument.

Mr. STAATS. I would think it would be a fairly serious matter, Mr. Chairman, to say to the employees of the Government that here you have had a funded system all these years and now you are going to be on a system which is going to depend upon the budget situation from year to year. I think that the employees are entitled to more assurance than that. I think the Government needs more assurance than that if it is going to attract and hold the kind of people we need to carry on the important responsibilities the Government has.

Mr. DANIELS. If you run into a situation as we did here recently where we had three continuing resolutions and the House was unable to agree upon those continuing resolutions, if the fund had to be appropriated from year to year, some of these retirees might have had to go for months without being paid. Would that be true if we ran into such a situation in the future?

Mr. STAATS. I simply would like to say we have been through these budget crises from time to time. I have been around Government for about 27 years and I know this happens. I do know it makes a good deal of difference if there is an orderly system for financing a program from one where a judgment has to be made from year to year as to the amount of money that you are going to put into the program.

Mr. DANIELS. Mr. Staats, I would like the remaining time to be shared by my colleagues so I call upon my colleague from North Carolina, Mr. Henderson, for questions.

Mr. HENDERSON. General, it is good to see you and I am appreciative of your statement. I would like to talk to you just a minute about the alternative, as I understand it.

It seems to me that the problem that we have is twofold. The planning that has been done from time to time with regard to the retirement fund perhaps was good at the time it was adopted, but changes have come along periodically which have thrown it out of kilter, plus the fact that we have not always faced up to the situation as it occurred. Looking at present-day conditions, if we knew that the manpower situation would remain constant, that pay would remain constant, other employee costs would be constant, then it would seem to me that the plan under H.R. 10912 adopted at this time and put into effect, less payments in the first year, other payments in the last, 30th year, would perhaps be sufficient. Looking more realistically at what history tells us and what we logically can anticipate, we are going to have growing Federal employment, growing pay costs, and that is the basis for your funding of the retirement system and has been basically; so it would seem to me that what we can realistically expect to happen is that if we take the financing or the plan of H.R. 10912, it would be increasing costs built into our basic plan and pile on top of that the increased pay provisions, and liberalization of the retirement system. For example, we are going to compound the payments in the 28th, 29th, and 30th year even greater than you would anticipate at the present time.

Our plan is all based upon what we see now.

Mr. STAATS. I think your point is well taken, Congressman Henderson.

Mr. HENDERSON. Even if we took your plan, with constant payments across the board, don't you feel that each and every time we have a pay increase and liberalize the retirement benefits, that we ought to

step up our appropriations the succeeding appropriation or fiscal year to cover increased cost of the pay and the increased cost of the retirement benefits.

Mr. STAATS. We believe definitely so. Our plan so contemplates that would be done. Actually, we incorporate in our alternative proposal the additional costs that would come as a result of cost-of-living adjustments for retirees, as well. It is my understanding that the reason that this feature was not incorporated in the Civil Service Commission's proposal is that they felt that the additional financing provided by the pegging arrangement would be sufficient. We believe when these increases occur they should be funded in the same way as other increases in the unfunded liability.

Mr. HENDERSON. It seems to me that your plan would be a better discipline, maybe would be the better way to put it, of Congress upon itself. What we would say is if we do not do anything else, if there are no cost-of-living increases, no pay increases, no other benefits added, this amount of money over your 20-year period, or I think we could even stretch out to 30 years and have a consistent annual payment, if we decided 30 years was better than the 20 years, that would reduce the amount but taking a longer period and it would be a level payment—that discipline upon ourselves to say that each time we take action, or action otherwise would be taken by law, that we would know what the cost was going to be each and every year and we would adjust for that.

Mr. STAATS. I think the important thing here is to have level payments. The question of the number of years is a matter which anyone might logically differ. The rationale we followed is that 20 years is roughly the life of an employee in the system at the time the liberalization or change takes place. In other words, at any given point of time he has about a 20-year period where he remains in the service and receives benefits after he leaves the service; whereas the Commission's rationale was pointed more to a life of an employee who served a full career in the Government.

As between these two approaches I do not know that we would feel that was nearly as important as the question of getting a level payment.

Mr. DANIELS. If the gentleman would yield at that point, are you wedded to the 20-year schedule? Why have you not stretched it out to 30 years?

Mr. STAATS. As I was just explaining, any figures you take of this kind, whether it be 20 years or 25 or 30 are far less important than the fact that we have a definite level of payment. We selected 20 years largely because this reflects the normal life of an employee in the service and receiving benefits after he leaves the service at any given point of time, because you have people who are about to retire, you have people in midcareer and you have people just beginning their career. We obtained this information from the report of the Bureau of Retirement and Insurance of the Civil Service Commission.

The Civil Service Commission's rationale for the 30 years is that this represents the life of an employee in the system if he came in at the beginning and stayed on to retirement. This is a matter of choice. I do not think you would be really making a mistake regardless of which approach you took. We think the 20 years represents a better rationale than the 30 years, but again we say that is much less important than to get a level payment.

Mr. HENDERSON. Mr. Chairman, I have one other point. I have heard discussed, General, and we would welcome your comment, that one of the problems of the civil service retirement system is the credit we give for military service. We talked briefly about the military retirement payment. I am thinking about the man who serves 2 years or an enlistment period of 3 years in the Vietnam conflict, as we know happened in Korea and World War II, and comes into the civil service retirement system and gets credit for those months of military service.

If we could determine that the military man was coming into the Government service, it would seem to me it would be logical at the time we project the cost of this war, or an individual's service, that we would add right into that budget the cost that would eventually come to the civil service retirement fund and those funds be placed in there to pay this out.

Obviously that is impossible, but what can we do except by way of supplemental appropriations to cover that.

Doesn't this system or either of these systems get somewhat at that problem?

Mr. STAATS. Since we understand that consideration is now given to military credit in computing normal cost, either of these systems gets at this problem with respect to current and future service. Also, to the extent that military credit accounts for part of the existing unfunded accrued liability, we get at it through providing for a payment equal to interest on the unfunded accrued liability.

Mr. HENDERSON. Finally, do you know of any study that has been done which would indicate to us what is the extent of our deficit now attributable to military service of our civilian employees?

Mr. STAATS. I do not know. Perhaps my colleagues do.

Mr. HENDERSON. I do not know that it would be any more than academic, but I certainly think we can all agree that there is a real cost to the civil service retirement fund by this benefit.

Mr. STAATS. Mr. Henderson, it was planned to do this in connection with the railroad retirement system. It must have been 10 years ago. We would be glad to check that point for you if you wish.

I am not aware of any current studies that have been made to try to measure what this represents in terms of the total unfunded liability to the civil service retirement system.

Mr. HENDERSON. We can agree that it is part of our problem.

Mr. STAATS. It is part of the problem. It is a substantial part of the problem if you take into account World War II and Korea, where you had the heavy numbers of people going into the service, either already in the civil service or immediately thereafter went into the civil service.

Mr. HENDERSON. Does not the Veterans Preference Act contribute to this, too, because it is the policy of the Federal Government to give preference to those who have served?

Mr. STAATS. It attracts more veterans into the service than the normal work population.

Mr. HENDERSON. Thank you, Mr. Chairman.

Mr. DANIELS. Now our colleague from North Carolina, Mr. Broyhill.

Mr. BROYHILL. Mr. Chairman, thank you. I do not have any questions. I appreciate your coming before the committee this morning.

I certainly agree with you that in the past we have hidden our heads in the sand on this particular problem and it is time we face up to it and decide what our policy is going to be in the future.

As I understand your answer to the chairman's question concerning the way this would be financed in the future, one of the reasons why you individually think that we should have a retirement fund rather than appropriated money directly for these retirement costs is that this would be leaving this whole retirement question up to the political whims of the future.

Mr. STAATS. That is part of the answer we are attempting to give. The other part of it is that as we liberalize benefits, as I am sure we will, as costs increase as life expectancy is going to increase, and other factors will change this cost, there ought to be the discipline, as Mr. Henderson refers to it, of having to face up to the cost of that at the time actions are taken or changes occur, otherwise, we run the danger of piling up our problem ahead of us.

We look at the first year costs without looking at what the total costs are going to be. That is the other side that I would emphasize perhaps equally to the first point which you made. I am speaking here maybe personally as much as anything else, we feel that maybe one of the reasons that we have not dealt with this problem in the past is the concern about the effect on the budget deficit in a given year. This is the reason that we emphasize the recommendations of the President's Budget Commission which, as you know, had representation on it from the Congress, the chairmen of the House and Senate Appropriations Committees and the ranking minority members of those two committees, the Secretary of the Treasury, the Director of the Budget, and myself on the Government side. The Commission, I think, is unanimous on this concept of incorporating trust funds into the budget. Therefore, we no longer have the problem of the deficit in the administrative budget. The administrative budget would no longer exist as we have known it in the past, and the deficit would not be based on the administrative budget but on the total cost of government. Therefore, the amount of money that would be transferred would simply show up as a transfer between funds.

It would not change the total size of the budget.

Mr. BROYHILL. On this point, it has been mentioned that one of the proposals that has been made, and you do not agree with that approach, and that is that we just let the fund go broke and pay these costs from future appropriations. Would that approach affect the deficit any more or less than the proposal which you have brought before the committee this morning?

Mr. STAATS. The reason, I believe, in part for the progression—the idea of increasing appropriations year after year in the Cabinet Committee proposal—was to minimize the effect on the administrative budget. That was a part of the consideration, whereas the level approach we are suggesting here would increase the amount to be appropriated in the early years.

What I am suggesting is that if the Budget Commission's approach is adopted, that this no longer is really a valid or meaningful argument, even in practical political terms, because the total budget will be the same either way.

Mr. BROYHILL. Thank you very much.

Mr. HENDERSON. Mr. Chairman, may I ask one other question on that point? Let us relate this to an individual who might go into debt to build a \$20,000 home, General. During the course of the 20-year mortgage period, while he is making payments on the mortgage, instead of increasing his payments and paying it out early, suppose the individual has a savings account in the bank, a savings and loan, and he is saving an amount of money that he could apply to his mortgage. If we relate this to his deficit, wouldn't you deduct the amount of money that he has saved in the savings account as applied to that mortgage indebtedness and therefore his deficit is not as much as it would be if he were not saving and was just paying his mortgage payments?

Does this relate to what you are saying with regards to the recommendation on the deficit—that if we have a good sound plan we really ought not to count the deficit situation without taking into account that we have a good financial plan?

Mr. STAATS. I am not sure that the parallel or the analogy is complete. If he had a mortgage on his house, he would have a level payment. That would be No. 1. If he had other assets or savings, he would have to make a judgment whether he paid off his mortgage faster as against alternatively investing that money in other assets which might yield him a higher return than the interest he is paying on his mortgage. I would think that the point here would be that he would be concerned about what his level costs are going to be all through this period. He would have to recognize that while his income might grow in the latter stages of the pay-off of that mortgage, his obligations may similarly grow. He may have children in college, he may have other costs which he would also have to take into account.

I think this is the point that the chairman was making a while ago. The \$3.8 billion is the present estimate cost of what that payment will eventually be even if there are no further increases in salaries or other liberalization.

There will be other liberalizations. There will be additional budget costs which this country will face. So I think the risk is that figure would not be \$3.8 billion, but something larger than that.

Mr. HENDERSON. Thank you, Mr. Chairman.

Mr. DANIELS. General, with respect to the payment of the costs, whereby employees make a certain contribution, say 6½ percent, and the Government agencies a similar 6½ percent, do you feel the contribution made by the employee is a fair and reasonable charge extracted from him, or that the Government should make a larger contribution?

Mr. STAATS. All we are suggesting here is that this is a matter which ought to be considered further and not just accept the concept necessarily that it has to be 50-50. We think the principle of some sharing is a desirable principle because of the discipline that it imposes on all of use who are interested in improved benefits.

We have to pay something immediately for any liberalization. I am not sure that it necessarily follows that it has to be 50-50. I think some different sharing of the normal cost can be justified.

I think you can justify it in terms of the experience of State and local government. I think you can justify it in terms of the experience of private employers. Either way it is done, the employer con-

tribution ought to be considered as a part of total compensation, so that when we are fixing pay levels we are looking not only at the size of the pay but also the size of fringe benefits.

Retirement is not the only fringe benefit by any means. These fringe benefits roughly are 25 percent of total compensation.

Mr. DANIELS. I would like to have your opinion as to which you deem most preferable, whether the cost-sharing ratio be established administratively or by Congress.

Mr. STATT. Under existing law, 6½ percent is deducted from employees' salaries and an equal amount is contributed by the employing agencies. At present, these contributions and deductions fall somewhat short of covering the full normal cost of the civil service retirement system. Both H.R. 10912 and our alternative approach would provide for covering normal cost in full, but in either case the cost-sharing ratio would be determined by the Congress.

H.R. 10912 would provide for equal sharing of normal cost by employees and employing agencies. Under our alternative approach we suggested that the Congress may wish to consider covering the full normal cost through deductions from employees' salaries and agency contributions in proportions which may be other than equal proportions and setting forth in law the specific cost-sharing ratio to be followed.

The Civil Service Commission would be authorized and required, under H.R. 10912, to adjust the percentage to be deducted from employees' salaries and the amount to be contributed by the agencies as necessary to meet full normal cost. Adjustments would be made annually, if necessary, to fix the percentage at the nearest multiple of one-fourth of 1 percent. This provision, however, would not authorize the Commission to change the cost-sharing ratio established by the Congress.

Calculating the amount of the normal cost of maintaining the civil service retirement system has been a function of the Civil Service Commission, based on actuarial valuations made by its Board of Actuaries. Adjusting the percentage to be deducted from employees' salaries and the amount to be contributed by the agencies to cover full normal cost—without, however, changing the cost-sharing ratio established by the Congress—would be a logical function of the Commission.

Regarding the broader question of the total fringe benefits being received by Government workers, we certainly believe that the executive branch should study this question, their relation to the total pay package, et cetera. We further believe that the results of such studies, together with the recommendations of the executive branch, should be made available to the Congress for its consideration.

Mr. DANIELS. I think it should be important, whether we should do it by law, whereby Congress would fix the amount, or whether it should be done administratively to the extent that it is proposed in this legislation.

On behalf of the committee, and myself personally, I want to thank you for coming here this morning and giving us the benefit of your views.

Mr. STAATS. Thank you very much. It has been a pleasure being here.

Mr. DANIELS. The subcommittee will stand adjourned and will meet at the call of the Chair. No one, as far as I have been able to ascertain, has been able to tell me or any of my colleagues when the House proposes to adjourn this year. So it would not be fair to my colleagues to set further hearings and then find that the House has adjourned. I think it would be safe if we resume these hearings in the early part of the next session of Congress.

(Whereupon, at 11:05 a.m., the subcommittee adjourned.)

○

Dear Sir, I have the honor to acknowledge the receipt of your letter of the 10th inst. in relation to the matter of the application for a license to the undersigned. The undersigned will send you a copy of the same as soon as it is received. I have also the honor to inform you that the same has been forwarded to the proper authorities for their consideration. I am, Sir, very respectfully,
Yours obedient servant,
J. H. [Name]