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On our cover: Cliveden, located at 6401 Germantown Avenue, is one of Philadelphia's outstanding Georgian mansions. It was built between 1763 and 1767 as a countryseat by Benjamin Chew (1722-1810), one of Philadelphia's distinguished lawyers and political leaders. The mansion was occupied by British troops during the Battle of Germantown on October 4, 1777. In June 1972 through the generosity of Chew's descendants Cliveden was transferred to the National Trust for Historic Preservation. (Photograph for Historic American Buildings Survey by Jack E. Boucher and courtesy of the National Trust for Historic Preservation, Washington, D. C.)

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Philadelphia's School Resources And the Disadvantaged*

By Anita A. Summers and Barbara L. Wolfe

Through the centuries, education has been regarded as the link between the individual and society. Plato and Aristotle saw education as essential to a stable political order. In the Middle Ages, education was seen to be essential to the unity of church and state. At the turn of this century, immigrants to America saw education as the path to assimilation and success. And today, many citizens regard education as the most powerful force to reduce the inequities experienced by minorities. It is not at all surprising, therefore, that the issue of who gets how much school resources receives much attention.

A host of sensitive questions has been unleashed. Are Black students in larger classes than non-Blacks? Do low-income students receive all or a lion's share of Federal funds? Are Spanish-speaking students taught by the most inexperienced teachers? The list of such questions is virtually inexhaustible. So are the concerns of parents and policymakers—the former, because of their concern over equality of educational opportunity and how much that goal costs; the latter, because their performance record of allocating school resources is on the line.

*The major findings of this article were presented at the 93rd Annual Meeting of the Citizens' Committee on Public Education in Philadelphia on June 13, 1973, at the PSFS Building. This material is part of a larger study of resource inputs and achievement outputs of Philadelphia's public school students, being conducted by the Department of Research of the Federal Reserve Bank of Philadelphia. The effects of various school inputs (teacher quality and equipment, for example), socioeconomic inputs (family income and race, for example), and school climate inputs (the number of disruptive incidents and the proportion of low-achievers) are being analyzed in relation to changes in pupil achievement over a period of years. Inputs important to low-achievers will be sorted from inputs important to high-achievers. Similarly, sorting will be done by race and by income levels.

The famous Coleman report[1] found that within school districts, and even within regions, resources were equally distributed between the advantaged and the disadvantaged. The important *Hobson* v. *Hansen* decisions[2] in Washington, D.C., in which a school system was ordered to make per pupil expenditures among the schools more equal, was based on evidence that resources were unequally distributed—between the poor and the rich, between Blacks and Whites. How has the Philadelphia School District performed?

Did Black, Spanish-speaking, and low-income students get more, the same, or less resources than others in Philadelphia's public schools? The educational report card for 1970–71 indicates a well-above-passing grade. *On the average,* for all three levels of public education, the School District's performance in resource allocation shows that where policy dictated equal distribution, the disadvantaged received resources equal to those received by the advantaged. Moreover, where policy delegated more resources to the advantaged, with the important exception of Federal funds, they received them. The results differed, however, for some resources, some levels of schooling, and some disadvantaged groups.

RESOURCE DISTRIBUTION AND EQUALITY OF OPPORTUNITY

Parents and policymakers may think resource distribution, because it is visible and measurable, adequately measures equality of educational opportunity. But clearly it does not.

Playground areas in schools with high proportions of Black pupils may be the same as in schools with low proportions, but that does not necessarily mean that equal opportunity for learning through play has been achieved. More resources are required to educate blind children than to educate sighted children. Yet equal resources to the blind and the sighted would certainly not represent equal educational opportunity. Similarly, equal resources to the environmentally advantaged and disadvantaged hardly represents equal educational opportunity. Ideally, what is needed is the knowledge of what package of school inputs is required for each type of child to equip him or her for educational growth. This package is not identifiable in the present state of the arts, however. So, parents, courts, and legislators keep looking at school inputs (resources) to keep tabs on equal opportunity.

Even if just inputs are studied, should each student receive the same quantity and quality of resources? Certainly not. Even for a school district of a large urban area, such as Philadelphia whose allocation-of-resource decisions are basically made centrally, sources of inequality readily suggest themselves. Many of these are within the School District's control but some are not.

Within the administration's control are resources specifically designed to go more heavily to certain categories of students. For example, expenditures on Federal programs should definitely show up as going more heavily to schools with higher proportions of low-income students. If, however, allocation decisions are made from what has been described as a "conspiratorial" model, then the "conspirators" (the Establishment) will determine who gets more resources. If rich taxpayers who want to send their children to public schools are the decision-makers, newer buildings might be occupied by student bodies with higher proportions of high-income pupils.

If allocation decisions are made in response to the most vocal voters, then, in recent years, more remedial education might be found in locations with more poor and more Blacks. All of these allocations, which might well end up less than equal, involve deliberate decision-making by the school administration.

Some allocations are uncontrollable, however. Expenditures on plant maintenance are

[1]James S. Coleman *et al., Equality of Educational Opportunity,* 2 vols. (Washington: Government Printing Office, 1966).

[2]*Hobson* v. *Hansen,* 269 F. Supp. 401 (D. D. C., 1967), affirmed Sub non. *Smuck* v. *Hobson,* 408 F. 2d 175 (D.C. Cir. 1969), *Hobson* v. *Hansen,* 337 F. Supp. 844 (D.D.C. 1971).

annually determined, but obviously the age of school buildings is not. The School District is saddled, in some way, with aging plant facilities and the problems of vandalism. Both of these burdens add up to something less than an equal distribution of plant maintenance expenditures. Economists cite yet another cause of less-than-equal distribution of school resources—the structure of the teacher's labor market. School systems in union-strong cities have a set of wages, hours, and benefits for public school employees. And Philadelphia's is no exception. Teachers, on a seniority basis, may transfer from one school to another, usually from a "harder" school to an "easier" one. "Better" teachers might then be expected to be found in "better" (higher income, fewer Blacks) schools.

Scrutiny of the distribution of resources cannot isolate those explanations which fit Philadelphia. Realistically it can and does underscore the importance of those political and economic elements that are administratively controllable as well as those that are not. The inevitable result is some unequal distribution of resources. Furthermore, a close look at whether the disadvantaged have larger classes or smaller playgrounds than the advantaged will not resolve the question of whether educational opportunity is equal for both groups because it is impossible to know the relevance of either to educational achievement.

But examination of the distribution of resources can reveal what really has been happening. For one thing, it can show whether a complaint about relatively inadequate resources at one school is an exception or a pattern for the entire School District. For another, it can show whether the announced allocation policies, such as Federal funds for the poor, are being carried out. In general, it can show whether the definitions of equity handed to the School District by the voters, the courts, and the legislature are being translated into resource allocation.

HOW CAN RESOURCE DISTRIBUTION BE MEASURED?

Examining the distribution of resources to the disadvantaged requires more than the anecdotal observations of public hearings and press clippings. It requires scrutiny of the resources in each and every school in relation to the proportion of disadvantaged in each of those schools.

The Numbers. Budgets provide the most readily available resource measures for individual schools. But these expenditure figures do not distinguish quality variations from quantity variations. If some schools spend less on science laboratories per pupil than others, does it mean that the former are more efficient, or that they have lower quality laboratories, or both? Whenever possible, using the per pupil size of the laboratories or the number of library books per pupil clearly is preferable. Both dollar and physical measures suffer, of course, because probably important "affective resources," such as the charisma of teachers, are excluded. But measuring these objectively is difficult, if not impossible.

The Relationships. The distribution of resources has been examined in relation to three groups of pupils generally regarded as disadvantaged—Blacks, Spanish-speaking, and low-income. All three levels of public education have been studied.

The number of dollars or physical units for each resource for each school was measured against the proportions of the disadvantaged groups. This procedure helps explain what proportions of the differences from one elementary school to another in Federal funds per pupil, for example, is related to differences in the proportion of low-income pupils. If differences in these expenditures are not related to the proportion of low-income students in the schools, then one must look elsewhere for the explanation, perhaps, to the relative strength of different parent groups. However, if a substantial proportion is explained, then the differences in Federal funds expenditures per pupil might be "caused" by the proportion of low-income students in the school. That is, if a higher proportion of

low-income students is associated with larger amounts of Federal funds per student, then cause and effect are suggested. (See Appendix tables for details on each of the resources examined.)

Whether or not the relationship is the desired one depends upon the objectives—compensatory or neutral—of the school administration regarding each of the different resources.[3] When the objective is compensatory, then the disadvantaged will get relatively more resources—they will be compensated for their "handicaps." Federally funded expenditures are clearly intended to be compensatory.

When the objective is to be neutral, then Blacks and Whites and the poor and the rich will receive equally from the school system. Most school resources, of course, are intended to be neutral in allocation. The interesting point here is whether they are, in fact, dispensed neutrally. Are there significantly more pupils per teacher in schools with high proportions of disadvantaged? Are the expenditures per pupil on libraries higher, lower, or the same among schools with widely differing proportions of disadvantaged?

A neat statistic for summing up all of the individual findings would simplify the problem of drawing conclusions. But no such statistic exists, and the conclusions must flow from the statistical significance of separate calculations and a judgment about the weight of evidence.

RESOURCE DISTRIBUTION: THE FACTS

Action usually followed edict in the "neutral" distribution of resources at all three levels of Philadelphia's public schools. However, this was less true with compensatory funds.

Among Elementary Schools. In elementary schools, neutrally intended resources were, *on balance*, distributed neutrally. Where there were more Blacks, Spanish-speaking, and low-income students, there were more vacant teaching positions, fewer experienced teachers, and a more intensely used school building. Offsetting this, more dollars were spent on each pupil and classes were smaller. The most significant finding, perhaps, was that Federal funds, compensatory in intent, went somewhat more to the schools with more Blacks and low-income pupils—but barely so. And these students were in schools with fewer high-achievers, more low-achievers, and more disruptive incidents. (More details are in Box 1 and Table 1 in the Appendix.)

Among Junior High Schools. *On balance,* neutrally intended resources, again, were parceled out equally to all sorts of junior high students. Where there were more Spanish-speaking and low-income students, the condition of the school buildings was poorer and the science laboratories more crowded. Further, where there were more Blacks and low-income students, there were more vacant teaching positions and less experienced teachers. Offsetting this, these students were also in schools where more money was spent per pupil, classes were smaller, and per pupil counseling and remedial education expenditures were greater. Federal funds, however, designed to be compensatory, did not flow in larger amounts to the schools with more disadvantaged *than to those with less*. As in the case of the elementary school students, the disadvantaged were in schools with more low-achievers and fewer high-achievers, though they were not, to any real extent, in schools with more vandalism and physical violence. (More details are in Box 2 and Table 2 in the Appendix.)

Among Senior High Schools. Among senior high students, too, neutrally intended resources were dispensed equally, *on balance*. Where there were more Blacks, Spanish-speaking, and low-income students, there were more vacant teaching positions and somewhat less experienced teachers. Where there were schools with

[3]Some characteristics of schools—for example, the proportion of pupils below the 16th percentile in the Iowa Achievement tests—are essentially outside the School District's control. As part of the school climate, the distribution of these characteristics has been examined.

BOX 1

ELEMENTARY SCHOOL RESOURCES AND THE DISADVANTAGED

For Black Students. For Black students, the *net* effect of the distribution of resources intended to be neutral appear to have been, in fact, neutral. Some neutrally intended items were distributed in a significantly compensatory direction—there were fewer pupils per teacher in schools with high proportions of Blacks, for example. Some neutrally intended items were distributed in a significantly counter-compensatory direction—there were, for example, higher proportions of teacher vacancies in school with higher proportions of Blacks. In all instances, however, the variation in neutrally intended resource outlay from school to school was not attributable, to any great extent, to the proportion of Blacks in the school. Variability from school to school did, indeed, exist—but not much of that was attributable to there being a larger or smaller proportion of Blacks in the school.

Some resource allocations were made, of course, with the deliberate intent to be compensatory. Such items—Federal funds and expenditures on remedial reading, for example—were, in fact, distributed in such a way that schools with high proportions of Blacks received more than other schools. Variability from school to school for these compensatory resources was, of course, intentional. But, here again, most of the variation was attributable to factors other than the proportion of Blacks—though, in the case of the Federally funded expenditures on an Educational Improvement Program, as much as 25 percent was attributable to the proportion of Blacks.

For Spanish-Speaking Students. For Spanish-speaking students, also, the *net* effect of resources intended to be neutral appear to have been, in fact, neutral. No strong items emerge where the school-to-school variation had a compensatory or non-compensatory direction which was explainable, to any large extent, by the proportion of Spanish-speaking students. It was true, however, that schools with higher proportions of Spanish-speaking students had significantly less experienced teachers (as measured by longevity salary per teacher), but, even there, the Spanish-speaking density accounted for only a little more than 7 percent of the variation in experience from school to school. Resources intended to be distributed in a compensatory fashion went to the Spanish-speaking students in a compensatory way, but barely so.

For Low-Income Students. For low-income students, the neutrally intended items were close to being neutrally distributed, but with some compensatory bias. Schools with higher proportions of low-income pupils had fewer pupils per teacher and fewer pupils per other professional staff—though they also had higher proportions of teacher vacancies and higher capacity utilization.

For the low-income students, the analysis of the distributions of compensatory funds revealed a result of particular importance. Federal funds were designed to be allocated to the poor. The variation from school to school in the amount per pupil of Federal funds should, therefore, have been almost entirely explainable by the variation in the proportion of low-income pupils. Something close to 100 percent should be the proportion of variation in Federal funds distribution attributable to variation in the density of low-income pupils in schools—rather than the 3.2 percent that emerged from the statistical analysis of elementary school pupils in 1970–71.

BOX 2

JUNIOR HIGH SCHOOL RESOURCES AND THE DISADVANTAGED

For Black Students. For these students, the net effect of the distribution of resources intended to be neutral appear to have been, in fact, neutral. Some neutrally intended items were distributed in a significantly compensatory direction—there were smaller classes, for example, in schools with higher percentages of Black students. Some neutrally intended items were counter-compensatory in their distribution—there were, for example, less experienced teachers and more vacant teaching positions in schools with proportionately more Blacks. The nature of the statistical results suggests that, at the junior high school level, higher proportions of Black students in some schools were an important "explanation" for these schools having more teacher vacancies, less experienced teachers, and smaller classes.

Remedial education expenditures, designed to be compensatory, did go more to densely Black schools—but the distribution of Federal funds did not indicate that any more went, on a per pupil basis, to schools with proportionately more Blacks.

For Spanish-Speaking Students. For these students, neutrally-intended resources appear to have been distributed essentially that way. Most of these items had a slightly compensatory direction, but barely so. However, schools with proportionately higher numbers of Spanish-speaking students were, on the average, rated in somewhat poorer condition and were older. Compensatory funds did not appear to go in larger amounts to schools with more Spanish-speaking students.

For Low-Income Students. For low-income students, the neutrally intended items were close to being neutrally distributed, with some counter-compensatory bias. Schools with higher proportions of low-income pupils had more money spent per pupil, but, in these schools, more vacant teacher positions existed and science labs were more crowded.

A somewhat unexpected conclusion emerged when the distribution of Federal funds was analyzed. The total of these funds, (designed, of course, to go to the poor) did not go to schools with many more poor than to schools with fewer poor—though one component, expenditures on counselor aides, did. Essentially, none of the variation from school to school, at the junior high level, in the distribution of Federal funds per pupil can be "explained" by variations in the proportion of low-income pupils!

more Blacks and low-income pupils, the condition of the school buildings was clearly inferior. Offsetting this, schools with these pupil characteristics also spent more dollars per pupil, had smaller classes, and used a smaller proportion of the school capacity. Compensatory-designed funds—remedial education and Federal money—were distributed as intended among the high schools. Unlike those dispensed to elementary and junior high schools, Federal funds went to those schools with higher proportions of low-income and Black pupils. School climate conditions (vandalism, the proportion of low-achieving pupils) militated against all three groups of disadvantaged pupils. But Black- and low-income-dominated schools bore the brunt of most of the adversities—older school buildings, poorer attendance, and more prevalent violence. (More details are in Box 3 and Table 3 in the Appendix.)

BOX 3

SENIOR HIGH SCHOOL RESOURCES AND THE DISADVANTAGED

For Black Students. Overall, those high school resources which were intended to be distributed neutrally were, with respect to Black students, distributed in such manner. There were more teacher vacancies and buildings in somewhat poorer condition in senior high schools with a proportionately higher Black pupil population, but many other resources tended to be somewhat favorable to this group. Federal and School District funds, which were intended to be compensatory, were clearly distributed in that way. Over 38 percent of the school-to-school variation in remedial education expenditures, 17 percent in counseling expenditures, and over 36 percent in Federal fund expenditures can be "explained" by school-to-school variation in the proportion of Black students. This distribution pattern differs considerably from that in the elementary and junior high schools.

For Spanish-Speaking Students. The distribution of neutrally intended school resources among schools, with respect to the distribution of Spanish-speaking pupils, was remarkably neutral. More items were in a compensatory direction than in a counter-compensatory one—but, not significantly so, with the one exception that capacity utilization declined as the proportion of Spanish-speaking pupils increased. Much of the variation in Federal funds among schools was directly related to the variation in the proportion of Spanish-speaking students. Other compensatory funds—remedial education, for example—were also distributed to these students in a compensatory manner. Again, this pattern differs from the compensatory funds distribution in the lower levels of schooling.

For Lower-Income Students. For low-income students, a study of the distribution of neutrally-intended resources indicates that the intentions were realized. Some items had a slightly compensatory characteristic, some had a counter-compensatory characteristic. Schools with higher proportions of low-income pupils had more teacher vacancies and were in poorer condition—but somewhat more money was spent per pupil. Compensatory funds on remedial education went more to schools with a poorer student population, and Federal funds were very strongly pointed in that direction. In elementary schools, only 3.2 percent of the school-to-school variation in Federal funds could be "explained" by the variation in the proportion of low-income pupils; in junior high schools, no portion could be so "explained"; but, at the senior high level, 45.7 percent can be "explained" in terms of the distribution of low-income students.

RESOURCE DISTRIBUTION: THE REASONS

In 1970-71, neutrally intended resources were, on the average (and for all three levels of schooling), distributed in a neutral fashion. While there were discernible tendencies for some resources to be consistently distributed in one direction or another, on balance all groups appear to have received remarkably neutral treatment.

While *overall* resources were distributed in such a way that schools with higher proportions of disadvantaged received no more than others, some nonneutral allocations emerge. Certain

inequalities, not necessarily "evil" ones, consistently surfaced.

For example, disadvantaged students, at all levels, tended to be at schools with higher percentages of vacant teacher positions. Is this evidence of a conspiratorial intent to provide a better education for the advantaged? Quite the contrary. Most likely, it reflects the state of the teachers' labor market. With wages identical at all schools and with teachers enjoying seniority exercising their right to transfer, inevitably many teachers move from "less desirable" schools to "more desirable" ones.[4] For the same reasons, schools with more disadvantaged pupils have less experienced teachers.

Disadvantaged students tended to be in schools of poorer condition. Was this because of an intent to have advantaged students in better schools because of an Establishment domination? Some vestiges of this might have existed, but the School Board membership and orientation of the administration lends little support to this explanation. Most likely, the relative shabbiness of the buildings reflected the fact that disadvantaged citizens tended, for economic reasons, to be concentrated in the oldest parts of the city, where the oldest school buildings were. The school building program of the past few years will most likely alter this finding.

Disadvantaged students tended to be at schools where more money was spent per pupil and where classes were smaller. Undoubtedly, this inequality reflects the efforts of the school administration to respond to the strongly articulated demands of the disadvantaged. Where more learning difficulties existed, more remedial measures were taken.

[4]More recent data, reflecting teacher surpluses rather than teacher shortages, might well show less (or no) difference in the proportion of teacher vacancies in schools with high proportions of disadvantaged and in schools with low proportions.

Finally, disadvantaged students were at schools which received more compensatory funds. These, of course, were consciously allocated. Counseling and remedial education resources went more to the Black and low-income pupil concentrations. This deliberate unequal distribution of resources was not carried out as conscientiously with Federal funds, however.

In short, school resources were not equally distributed among Philadelphia schools for a number of reasons. For one thing, some funds were intentionally not distributed in this way. For another, there were longstanding conditions related to the urban population distribution about which the School District can do little. Not to be overlooked, too, were the mechanisms by which teachers choose their schools and their salaries.

CONCLUSIONS

In comparison with the Washington, D. C. public school allocations, condemned by the U. S. District Court in the *Hobson* v. *Hansen* cases of 1967, 1969, and 1971, the Philadelphia School District, then, comes out very well indeed. There was, on balance, equality in the distribution of neutrally intended resources. School District administrators would not have been found wanting in terms of this major legal yardstick for determining intradistrict equality.

The absence or presence of equality, however, is hardly synonymous with the absence or presence of equity. The "just" distribution is for the citizens, the courts, and the legislators to decide. Clearly, an absolutely equal distribution of resources to students of varying sociological and economic backgrounds would not provide this. Presumably, the "just" distribution is the one which results in an equal opportunity to achieve an educated state for all.

Appendix

BACKGROUND OF TABLES

The major detailed conclusions about the relationship between the distribution of resources and the distribution of the disadvantaged among the Philadelphia public schools are summarized in the three boxes in the body of the article. They derive from statistical calculations made for each level of schooling, the results of which are given in more detail in Tables 1, 2, and 3. The results use these particular data, classification of resources, and statistical procedures:

Data: For each elementary, junior high, and senior high school in the Philadelphia School District, data were compiled for many resources—instructional salary per pupil, condition of school buildings, Federal funds per pupil, for example. For each of the schools, data on the proportion of Black students, the proportion of Spanish-speaking students, and the proportion of low-income students—the disadvantaged—were put together. This was the data base for comparing the distribution of resources with the distribution of the disadvantaged.

Classification of Resources: Resources were classified in three ways:

1. **Intended to be neutral.** These are resources which are intended to be distributed in a manner unrelated to the proportion of disadvantaged pupils. The School District does not intend that the number of pupils per teacher, or the average experience of teachers, or the expenditures per pupil on kindergarten in different schools be, in any way, determined by the proportion of Black, low-income, or Spanish-speaking pupils.

2. **Intended to be compensatory.** These are resources which are intended to go to particular groups of students to "compensate" them for their socioeconomic handicaps. Federal funds, for example, are intended to go to the poor; remedial education is intended to go to the groups disadvantaged by minimal preschool motivation and education.

3. **The world as it is.** There are many characteristics of the school environment, over which the School District has little control and impact. The proportion of low-achieving pupils, the number of disruptive incidents, and average daily attendance are examples.

Statistical Procedures: For each resource, for each level of schooling, the amount in each school was related to the percentage of Blacks, the percent of Spanish-speaking, and the percent of low-income by simple linear regressions. In each case several calculations were made:

1. **Percentage of variability explained.** How much of the elementary school-to-school variation in, for example, number of pupils per teacher was attributable to the school-to-school variation in the proportion of Black pupils? If all of it was, the statistical measure would yield a result of 100 percent (r^2 would equal 1). In fact, the result was 10.5 percent.

2. **Statistical significance of results.** An index (the T-ratio) was calculated in each case. All those results which were determined to be statistically significant are presented in the tables.

INTERPRETING THE TABLES

Each table has two types of classifications—one relating to resources, one relating to the disadvantaged. Resources are classified as to whether the School District's intent was to distribute them neutrally or to distribute them in a compensatory manner—or as to whether the School District has to accept "the world as it is." If, an item intended to be neutrally distributed, is found to go more to the disadvantaged, than it is listed under a column headed compensatory; if it is found to go less to the disadvantaged, then it is listed under counter-compensatory. In Table 1, for example, the capacity utilization of elementary schools is classified as an item not intended to be affected by the proportion of disadvantaged. Was it, in fact, unrelated to the proportion of Blacks? The answer, since it is listed in the counter-compensatory column, is no—capacity utilization was higher in schools with higher proportions of Blacks. In Table 2, the number of attending pupils per laboratory in junior high schools—again, a "neutral" resource—was found to be counter-compensatory for the low-income students. Schools with higher proportion of low-income pupils had more pupils in each lab.

The second sections of each table, labeled "intended to be compensatory," contain the information about whether resources which were intended to go more to the disadvantaged, did in fact do so. Thus, expenditures on remedial education went in the direction of the Blacks and the low income at the elementary school level (Table 1), but not to the Spanish-speaking. At the junior high level, they went to the Blacks, but not to the Spanish-speaking and low-income (Table 2). And, at the senior high level, they went to all three groups (Table 3).

In the third section of the tables, one can see how some school environmental characteristics ("the world as it is") relate to the percentage of disadvantaged. In all three levels of schooling, things are worse off in schools with higher proportions of disadvantaged—there are fewer pupils above the 85th percentile, more disruptive incidents and more pupils below the 16th percentile. They are counter-compensatory in direction.

The tables contain information, not only on the direction of the distribution of resources to the disadvantaged—compensatory of counter-compensatory—but, on how much school-to-school variation in the distribution of resources is attributable to the proportion of disadvantaged. Thus, while instructional salary cost per pupil is higher in elementary schools with higher proportions of Blacks, this factor—the proportion of Blacks-only explains 3 percent of the school-to-school variation (Table 1). At the senior high school level (Table 3), 21.1 percent of the difference in the condition of the buildings is related to the difference in the proportion of Black pupils—to the disadvantage of the Blacks. Again, in Table 3, 41.8 percent of the school differences in average daily attendance is related to differences in the proportion of low-income pupils—where there are more low-income pupils, there is much lower average daily attendance.

TABLE 1

PHILADELPHIA ELEMENTARY SCHOOL CONDITIONS 1970–71, IN RELATION TO THE DISTRIBUTION OF DISADVANTAGED PUPILS

Blacks		Spanish-Speaking		Low-Income	
Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items
Intended To Be Neutral		Intended To Be Neutral		Intended To Be Neutral	
Total cost per pupil (2.2%)	% of teacher vacancies (7.0%)	General educ. support per pupil (1.9%)	% of teacher vacancies (2.4%)	Total cost per pupil (5.6%)	% of teacher vacancies (9.5%)
No. of pupils per teacher (10.5%)	Exp. per pupil on music (1.9%)	Exp. per pupil on supervision & clerical (1.8%)	Longevity salary per teacher (7.2%)	General educ. support per pupil (5.2%)	Longevity salary per teacher (1.9%)
Instructional salary per pupil (3.0%)	1972 capacity utilization (1.9%)	Condition of annex buildings (4.7%)	Exp. per pupil on Basic skills, grades 1–3 (.8%)	No. of pupils per teacher (15.4%)	
Exp. per pupil on Kindergarten (2.2%)				No. of pupils per other prof. staff (8.4%)	
				Instructional salary cost per pupil (5.6%)	
				Exp. per pupil on kindergarten (2.5%)	
				Exp. per pupil on Basic Skills, grade 6 (.6%)	
				Exp. per pupil on plant operation and maint. (2.8%)	
				Exp. per pupil on supervision and clerical (3.9%)	

TABLE 1 (continued)

PHILADELPHIA ELEMENTARY SCHOOL CONDITIONS 1970–71, IN RELATION TO THE DISTRIBUTION OF DISADVANTAGED PUPILS

Blacks		Spanish-Speaking		Low-Income	
Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items
Intended To Be Compensatory		Intended To Be Compensatory		Intended To Be Compensatory	
Exp. per pupil on remedial educ. (5.6%)				Exp. per pupil on remedial educ. (3.6%)	
Exp. on E.I.P. counseling (11.6%)				Exp. on E.I.P. counseling (10.4%)	
Total Federal funds per pupil (3.4%)				Total Federal funds per pupil (3.2%)	
The World As It Is		The World As It Is		The World As It Is	
	% of pupils above 85th percentile (22.2%)		% of pupils above 85th percentile (3.4%)		% of pupils above 85th percentile (29.6%)
	% of pupils below 16th percentile (38.2%)		% of pupils below 16th percentile (13.5%)		% of pupils below 16th percentile (41.6%)
	No. of disruptive incidents (15.4%)				No. of disruptive incidents (4.8%)

NOTE: Percentages in parentheses refer to proportion of school-to-school variation in amount of resources explained by school-to-school variation in density of disadvantaged groups. All those items for which the results were statistically significant are listed.

TABLE 2

PHILADELPHIA JUNIOR HIGH SCHOOL CONDITIONS, 1970–71, IN RELATION TO THE DISTRIBUTION OF DISADVANTAGED PUPILS

Blacks		Spanish-Speaking		Low-Income	
Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items
Intended To Be Neutral		Intended To Be Neutral		Intended To Be Neutral	
General education support per pupil (35.8%)	% of teacher vacancies (58.1)			General education support per pupil (15.9%)	% of teacher vacancies (28.0%)
No. of pupils per teacher (20.8%)	Longevity salary per teacher (15.5)				No. of enrolled pupils per lab (10.5%)
					No. of attending pupils per lab (9.0%)
Intended To Be Compensatory		Intended To Be Compensatory		Intended To Be Compensatory	
Expenditure per pupil on remedial education (14.1%)				Federally funded expenditures per pupil on counselor aides (33.4%)	
Federally funded expenditures per pupil on counselor aides (12.4%)					
The World As It Is		The World As It Is		The World As It Is	
	% of pupils above 85th percentile (24.4%)		Age of building (10.8%)		% of pupils above 85th percentile (38.2%)
	% of pupils below 16th percentile (51.2%)		Average daily attendance (.2%)		% of pupils below 16th percentile (60.9%)

NOTE: Percentages in parentheses refer to proportion of school-to-school variation in amount of resource explained by school-to-school variation in density of disadvantaged group. All those items for which the results were statistically significant are listed.

TABLE 3

PHILADELPHIA SENIOR HIGH SCHOOL CONDITIONS, 1970–71, IN RELATION TO THE DISTRIBUTION OF DISADVANTAGED PUPILS

Blacks		Spanish-Speaking		Low-Income	
Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items	Compensatory Items	Counter-Compensatory Items
Intended To Be Neutral		Intended To Be Neutral		Intended To Be Neutral	
	% of teacher vacancies (32.0%)	1972 capacity utilization enrollment (22.7%)		Expenditure per pupil on music (16.3%)	% of teacher vacancies (17.8%)
	Condition of main building (21.1%)	1972 capacity utilization (attendance) (13.7%)			Condition of main building (31.8%)
	Condition of annex (38.8%)				
Intended To Be Compensatory		Intended To Be Compensatory		Intended To Be Compensatory	
Expenditure per pupil on remedial education (38.2%)		Expenditures per pupil on remedial education (21.5%)		Expenditure per pupil on remedial education (20.3%)	
Expenditure per pupil on counselling (17.0%)		Total Federal funds per pupil (48.9%)		Total Federal funds per pupil (45.7%)	
Total Federal funds per pupil (36.5%)		Federally funded expenditures per pupil on counselor aides (22.7%)		Federally funded expenditures per pupil on counselor aides (58.6%)	
Federally funded expenditures per pupil on counselor aides (32.2%)					
The World As It Is		The World As It Is		The World As It Is	
	Age of main building (16.4%)				Age of main building (18.3%)
	Average daily attendance (48.4%)				Average daily attendance (41.8%)
	No. of Disruptive incidents (14.6%)				

NOTE: Percentages in parentheses refer to proportion of school-to-school variation in amount of resources explained by school-to-school variation in density of disadvantaged groups. All those items for which the results were statistically significant are listed.

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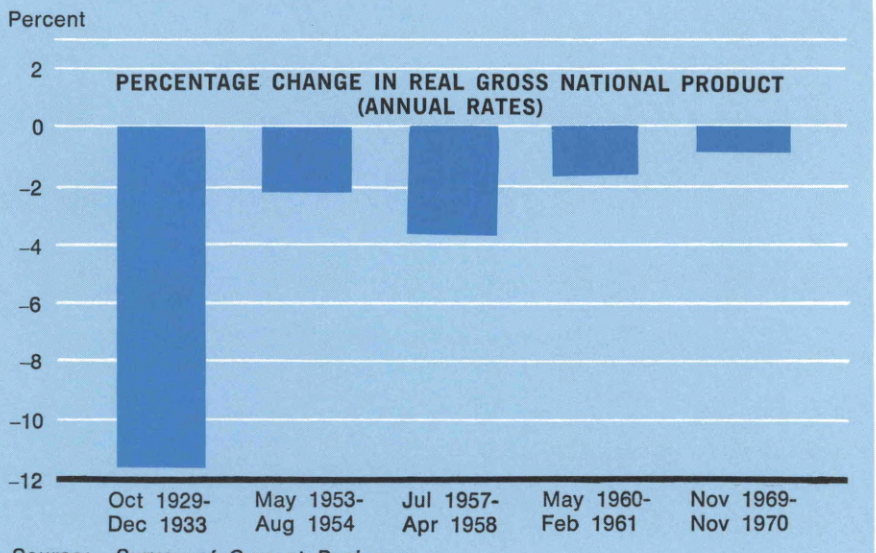
Persons in the Third District may direct requests for loan of the film to Truth in Lending, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101. Such requests should provide for several alternate presentation dates.

Milder Economic Impact with Continued Inflation Characterizes Recent Recessions

CHART 1

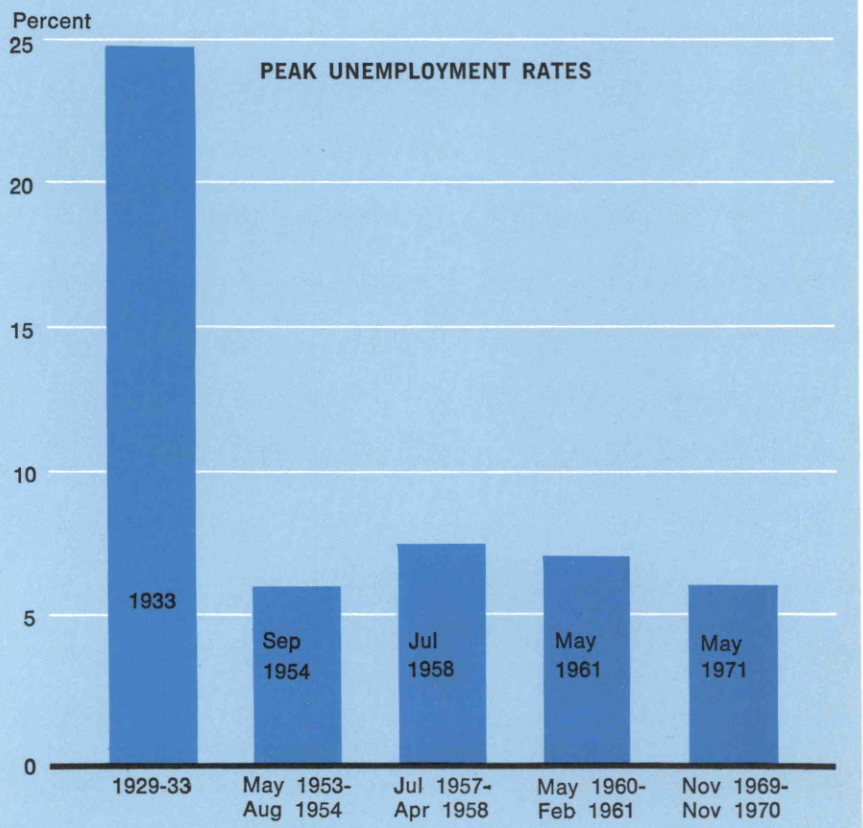
WHEN COMPARED WITH THE GREAT DEPRESSION, RECENT RECESSIONS SHOW MUCH MILDER DECLINES IN ECONOMIC ACTIVITY (ADJUSTED FOR PRICE CHANGES) . . .



Source: *Survey of Current Business*

CHART 2

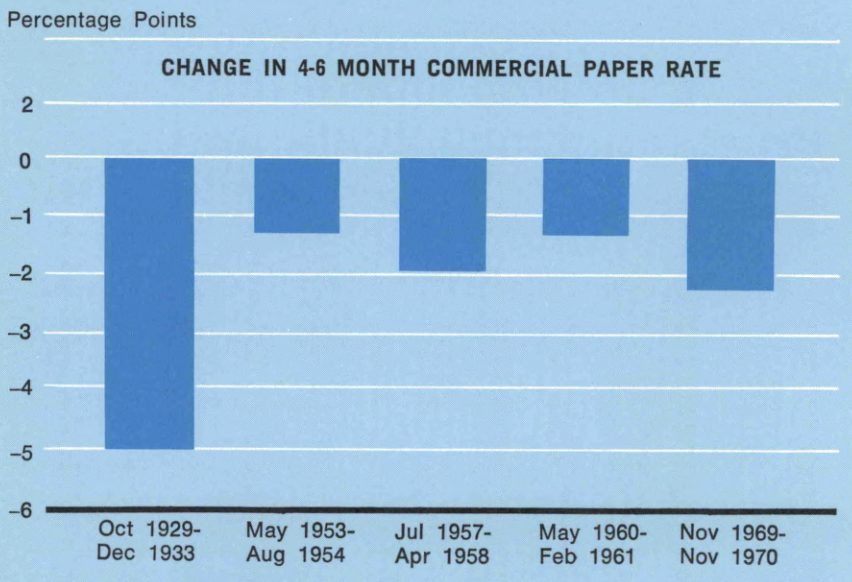
SO THAT A CONSIDERABLY SMALLER PROPORTION OF THE LABOR FORCE WAS JOBLESS DURING RECENT SLOWDOWNS . . .



Source: *Survey of Current Business*

CHART 3

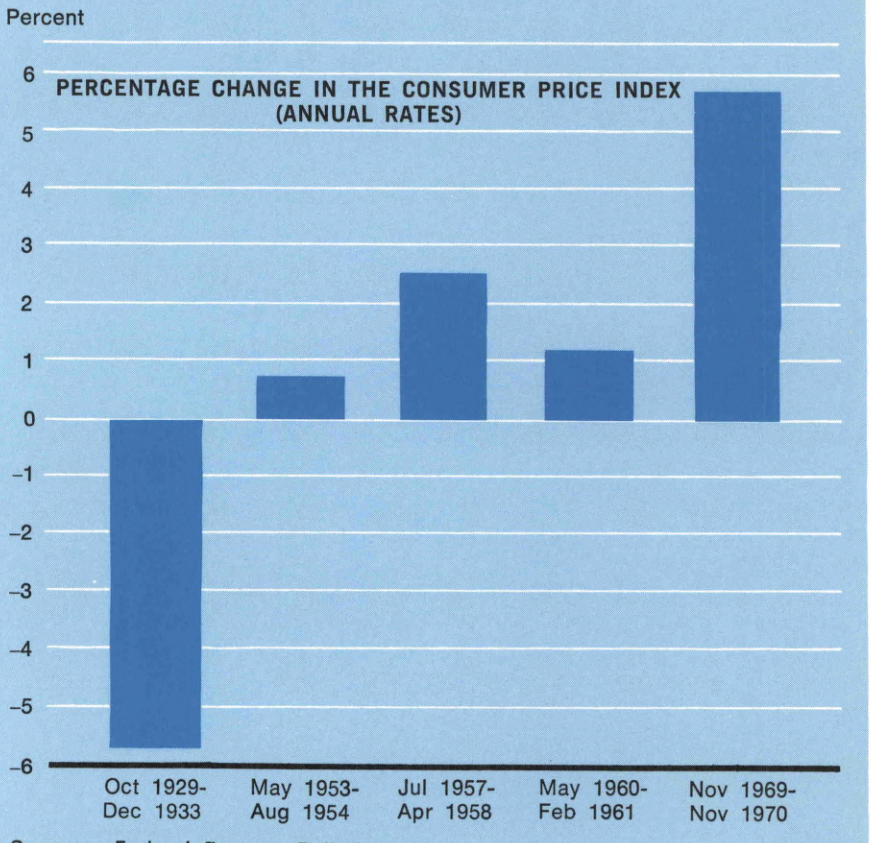
AND FINANCIAL MARKETS SUFFERED MUCH SMALLER EFFECTS IN TERMS OF SHORT-TERM INTEREST RATE DECLINES.



Source: *Federal Reserve Bulletin*

CHART 4

BUT WHILE PRICES DECLINED IN THE GREAT DEPRESSION, RECENT RECESSIONS HAVE DISPLAYED RISING PRICES AND A CONTINUATION OF INFLATION.



Source: *Federal Reserve Bulletin*

Private Pensions: Who Gets What When

By George Oldfield

These days most workers expect more than a pocket watch and a pat on the back when they retire. While virtually all workers expect Social Security (Old-Age, Survivors, Disability, and Health Insurance or OASDHI) beneifts upon retirement, a rapidly growing portion of the labor force is enrolled in private pension plans. In 1940, 4.1 million workers (about 13 percent of the private sector work force) were enrolled in private programs. By the end of 1971, some 36 million workers (about half the private sector work force) participated in private plans with combined total assets of over $150 billion.[1] As a result of this steady growth, the private pension system has recently become the focus of critical attention and debate.

Although a worker's promised benefits may appear to be a sure thing while they are being earned, these benefits may disappear for a variety of reasons. A recent analysis by the Treasury and Labor departments shows that about 10,000 workers lose between $20 million and $30 million in promised benefits each year as a result of pension plan terminations. Additional complaints about the present system are voiced by workers who lose accumulated benefits when changing jobs. Consequently, employers, workers and legislators are exploring ways of restructuring the pension system and eliminating its present shortcomings.

All of the varied proposals for reform suggest that too much uncertainty is attached to "who gets what when" with the existing private pension system. Since much of this uncertainty relates to operational details of plans such as funding, vesting, portability and insurance,

[1] *Life Insurance Fact Book 1973* (New York: Institute of Life Insurance), pp. 37, 41.

reform proposals generally focus on these narrow aspects of the system. Unfortunately, this emphasis on detail leaves another area for reform relatively undeveloped—the freedom of individuals to choose the type of pension they desire apart from the job selection decision.

IS WHAT YOU SEE WHAT YOU GET?

Most private pension programs are designed to supplement individual Social Security benefits. However, while OASDHI is a compulsory transfer scheme designed to provide a minimum living standard for those no longer working, private plans are voluntary and, in some respects, resemble retirement investment programs.[2] (See Box 1 for a discussion of the existing private system). Through pensions, workers can build retirement income during their productive years and receive their remuneration later when they are no longer generating income.

The benefit schedule of a private pension plan is usually determined by an employee's length of service and earnings history. Benefit schedules relate retirement income to the number of years of service or they may pay a fixed yearly amount for all covered retirees. In addition, Social Security benefits may be taken into account with private pension benefits decreased by some amount to reflect earnings covered by OASDHI. Although pension benefits are earned during employment, taxes on benefits need not be paid until a worker retires and collects the benefits. This usually places the beneficiary in a lower tax bracket than at the time that the benefits were earned. So pension plans have some characteristics of a tax-free savings program.

More and more employees are now participating in plans in which part of their total compensation is in the form of pension credits. Since these pension plans are generally touted as deferred income-retirement schemes, many workers have come to feel that a guaranteed pension is a right of employment. However, all pensions are not created equal. Pension "rights" presently vary widely from firm to firm and worker to worker. So, "who gets what when" from the private pension system depends on the characteristics of each individual pension scheme, especially the funding, vesting, portability, and insurance aspects of the plan.

Funding. Funding is the most crucial element in understanding who gets what when from private pensions. Without adequate provision for its obligations, a pension plan will eventually terminate. To determine how benefits are funded, actuarial assumptions are made concerning expected employee turnover, mortality rates, future wage increases, and earnings performance of the plan's assets. A pension plan's balance sheet consists of two broad categories of liabilities—normal obligations and past service obligations. *Normal obligations* refer to benefits earned by employees after the plan has been established. *Past service* obligations are those benefits that are credited to employees for their tenure prior to the plan's adoption. For example, suppose a plan is established today at XYZ company that provides $100 monthly at retirement for workers with over 30 years service. These workers may immediately qualify for this benefit even though no pension plan existed during their past service. Workers hired by XYZ today and those continuing employment create no additional past service obligation. Their future credited time is a normal obligation. As a pension plan matures over many years, past service obligations dwindle as the employees covered by these credits retire and die. At the same time, normal obligations become the dominant liability of the plan. However, past service obligations may increase substantially if increases in pension benefits are granted retroactively.

Current Internal Revenue Service regulations require that normal obligations be funded as they are earned by employees (that is, on a current basis). However, past service obligations need not be funded at all. Clearly, a 100 percent immediate funding of past service obligations through a lump sum assessment would be

[2]Donald J. Mullineaux, "Paying for Social Security: Is it Time to 'Retire' the Payroll Tax?" *Business Review* of the Federal Reserve Bank of Philadelphia, April 1973, pp. 3–10.

BOX I

PRIVATE PENSION PLANS: FACTS AND FIGURES

Private pension plans can be roughly divided into two major categories. Insured pension plans are administered by life insurance companies. At the end of 1971, 11.5 million workers participated in such plans with assets totaling $45.5 billion. The prevalent type of insured program is a deposit administration plan. In this arrangement, a firm contracts with a life insurance company to provide a pension program with specified benefits to its employees. Payments are made into a trust administered by the insurance company which provides an insured annuity to workers who retire. In a noninsured program, a company establishes its own pension program. Noninsured pension plans covered 24.5 million workers at the end of 1971 with assets totalling $106.4 billion. Most noninsured plans are trustee-administered. Payments are made into a trust which invests the contributions and pays the benefits. Commercial banks manage about 75 percent of these trusts. Under both insured programs and noninsured trust plans, the mechanics of pension operations are essentially similar.

As the benefits owed by a pension plan (its obligations) are funded, earning assets are acquired by the plan. It is important to remember that only assets of a pension plan, not the assets of the sponsoring company, back the claims of the plan's participants. Therefore, the management of a plan's assets can greatly influence a private program's ability to meet its obligations. Most private pension funds are invested in a variety of marketable securities. This includes, on average, corporate stocks (61 percent), corporate and foreign bonds (29.4 percent), mortgages (4.6 percent), and U. S. Government securities (2.7 percent). The balance is held in cash and other securities. Furthermore, a pension plan's earnings from its investments are tax-free.

The yearly amount paid into a pension plan (total contributions) is keyed to the expected earnings generated by the program's assets. This is because a plan's earnings can be used to fund its obligations. Thus, if it is assumed that a plan's investments will return 10 percent yearly, contributions can be lower than if only a 5-percent annual yield is anticipated. To demonstrate the effect that earnings have on contributions, a recent study indicates that an improvement in earnings yield of ¼ percentage point allows a reduction in pension contributions of 4 to 6 percent. Thus, plans whose assets perform well generate large savings in contributions. Conversely, less-than-expected earnings mean pension contributions must increase.

Sources: *Life Insurance Fact Book 1973* (New York: Institute of Life Insurance), pp. 37, 41; Irwin Friend *et al., Mutual Funds and Other Institutional Investors: A New Perspective.* A Twentieth Century Fund Study (New York: McGraw-Hill Book Company, 1970), p. 123; *Wall Street Journal,* March 13, 1973, p. 35.

extremely burdensome for a firm and its employees. The only requirement for funding these obligations is that the firm not allow the unfunded portion to expand after establishment of the plan.[3] Thus normal obligations are fully funded and provide cash for investment in earning assets. Conversely, most pension plans fund past service obligations over a period of 30 to 40 years. At that point, a plan becomes

[3]However, IRS regulations effectively prevent funding past service obligations at a faster yearly rate than 10 percent of the original past service obligation. Contributions to cover past service obligations in excess of 10 percent are not tax-exempt.

100 percent funded and assets offset all obligations.

However, even though all workers' accrued obligations are fully funded on a sound actuarial basis (thus virtually eliminating any solvency problems), some employees may fail to get a cent in retirement income from the plan. This can occur if workers lack ownership or "property rights" in their pension credits.[4]

Vesting and Portability. A "fully vested" worker has full ownership of his accrued pension credits. He receives retirement income from his original employer's plan even if he leaves this job to accept a position with a different firm. Partial vesting occurs when an employee has property rights in some portion of his total pension credits. Vesting provisions vary greatly among plans. In many programs, a worker's pension becomes vested well before retirement, either after some fixed employment period or at some predetermined age. In other plans, vesting does not occur until very near retirement. A worker who frequently changes jobs with nonvested pension provisions may be left with a very small or nonexistent pension. This can happen even though contributions into plans have apparently been occurring during his entire career. Thus stringent vesting requirements maintain certain features of the original "worthy worker" philosophy of pensions. Only those employees with lengthy and faithful records with a company qualify for sizable benefits (see Box 2).

The property rights associated with vesting are usually limited by "nonportability," which means that a worker is unable to withdraw his accrued pension benefits from one employer's pension plan and invest them in another program upon changing jobs. Most plans prohibit such transfers. However, multi-employer plans where all sponsors contribute to a common pool sometimes have a portability feature, although it is usually limited to the group of common sponsors.

Vesting and portability are related but not identical concepts. Workers who change jobs with vested but nonportable pensions must start each new job with no pension seniority in the new plan. Since benefits generally accrue with length of service, one pension earned over 30 years could yield substantially larger benefits than several shorter-term pensions that also represent 30 years' work. Clearly then, both vesting and portability contribute to the certainty of receiving a known amount of income upon retirement. However, one uncertainty remains—the possibility of bankruptcy. Pension insurance represents a way of coping with the risk of plan insolvency.

Insurance. If all private pension programs were fully funded and prudently invested, there would be no need for pension insurance because insolvency would not be a threat. Unfortunately, this is not always so. Thus, pension insurance[5] is attractive for two reasons. First, a plan whose assets are improperly or imprudently invested can experience large capital losses. If such a program is terminated, the remaining funds might not cover all vested obligations. Second, if a plan with substantial unfunded past-service obligations is terminated, insufficient funds may exist to cover all vested benefits.

[4]Another type of private pension plan is the "pay-as-you-go" system. Each year's benefits to retirees are funded on a current basis. Thus, no substantial reserves backed by earning assets exist to protect the promised benefits in the event of plan termination. In effect, the procedures used in these plans transfer earnings from present productive employees to present retired workers. Such private pension programs operate much like Social Security. However, any pension plan that pays benefits to retired workers that were not funded from the recipients' own wage packages contains an element of transfer payment because the benefits paid usually must be funded from the compensation of current employees.

[5]Note that pension insurance differs in an important sense from the concept of an insured pension. In an insured pension program, the annuity paid to a retiree is insured by the administering life insurance company *once the worker retires*. However, other vested benefits not being paid are not insured. In plans with pension insurance, all vested benefits are insured.

BOX 2

VESTING MEANS MONEY

The vesting provisions of a plan determine which individuals are guaranteed their retirement income, assuming the plan remains solvent. Consequently, vesting bears directly upon funding and the amount of yearly contributions necessary to keep a plan viable. If a worker leaves employment before his pension benefits become vested, the funds in his normal obligation account (which is fully funded) and any funds in his past service account (if he is covered by such obligation) remain in the plan's kitty. These funds can be used to meet obligations to other workers, and contributions can be reduced by the same amount. Therefore, rapid turnover of nonvested employees generates funds which can be credited to the obligations owed to other workers without additional contributions. In stable plans where new nonvested entries into the pension program roughly equal nonvested exits from the pension program, only vested benefits need be continously covered by contributions. The other entries and exits cancel out.

This process can be more easily understood by viewing funded obligations as comprising two pools of money. Over a given period, the nonvested pool remains fairly stable as nonvested employees enter and leave the plan. During this period, some workers move into the vested category. This represents a withdrawal of funds from the nonvested pool and a deposit of funds into the vested kitty. Hence, the only contributions required into the nonvested pool are those necessary to meet such withdrawals. Contributions to the nonvested pool can be minimal if stringent vesting standards prevent workers from becoming vested and if the assets financed by the nonvested pool of funds realize substantial earnings. Moreover, if a vested participant leaves employment, his funds remain in the plan until retirement age is achieved. Thus the assets financed by his vested funds also remain in the plan and the earnings from these assets may be used to reduce other contributions.

Since the pension plan's assets, not those of the sponsoring firm, usually back pension obligations, termination of an insufficiently funded plan with uninsured vested benefits may mean that many workers are left with a piddling pension. Thus pension insurance is a potentially powerful tool for guaranteeing retirement income.

CORRECTING THE OBVIOUS ILLS: BALANCING COSTS AND BENEFITS

Most specific complaints about the private pension system relate to specific items such as inadequate funding, rigid vesting requirements, and the lack of portability and insurance. As a result, most reform proposals call for stricter funding requirements, minimum vesting standards, and statutory insurance coverage. All these proposals are designed to increase the likelihood that workers with access to a private plan will receive a substantial pension at retirement. However, the benefits that might accrue from additional regulation of the private pension system must be weighed against the costs of such regulation.

For example, any major and abrupt change in the present pension system could have a significant employment and price impact on the economy. A regulation requiring more lenient vesting requirements (that is, after fewer years participation) would mean a significant increase in contributions into the presently nonvested portions of plans covered by the regulation. If workers (or their unions) are unwilling to sacrifice present wages to finance these contributions, firms might adjust their production and pricing decisions. Product price increases might generate additional revenues. At the same time firms would reduce their labor force and

release less productive employees, thus maintaining a parity between worker productivity and compensation. Alternatively, profits could be sacrificed to provide additional funds, or benefits could be reduced. Most likely, some combination of these effects would be manifest. However, if workers accurately value the additional benefits they receive with vested rights, no economic impact is necessary. The composition of the wage package can be altered to reflect the new form of compensation. Thus, the net impact of mandating more lenient vesting requirements is not obvious.

The regulatory and administrative costs associated with other proposals are numerous. For example, portability requires widespread participation in a transfer system to allow vested benefits to be taken from job to job. Then, clearing houses may have to be established to facilitate the transfer of such benefits. As a result, the costs of administering the clearing process must be borne by some sector of the economy. The operation of an insurance program also involves some costs. Premiums are an obvious example. However, indirect costs are also associated with insurance services. Resources must be devoted to coping with the "moral hazard" dilemma of pension insurance. A moral hazard occurs when the umbrella of insurance protection encourages various foolhardy or illegal practices contrary to the purpose of insurance coverage. For example, a firm suffering from competitive or collective bargaining pressure might grant pension benefits beyond its long-run ability to fund them. Guaranteeing that pension plans do not promise more than they can deliver is an indirect cost that arises from an insurance program.

In short, while there are a number of ills in the current pension system, curing them is not a costless process. It is important to remember that mandated change is not a free good, and that the benefits derived from regulation should outweigh the costs. One method of minimizing supervision and regulation costs is to construct simple rules of thumb that automatically apply to a wide variety of events. For example, a simple rule for coping with moral hazard in pension insurance involves insuring vested benefits with a lag. Only vested benefits granted more than three years prior to plan termination would be covered. Another method for minimizing regulation costs is to design competitive institutions. Clearing houses and insurance organizations that are forced to price their services competitively should lead to less administrative waste and more resources available for benefits. Moreover, since the general idea of competitive institutions fostering the efficient provision of pension services seems attractive, perhaps competition should not be limited to the auxiliary aspects of pension coverage. That is, why not make pension plans themselves competitive?

A MODEST PROPOSAL: FREEDOM OF CHOICE

Currently most pension reform proposals attempt to cope with the specific complaints about the system discussed earlier. However, a number of broader aspects of the pension system can also be identified as problem areas. First, pension contracts are usually complex and difficult to understand. When other fringe benefits are also lumped into the wage package, the value of total compensation is difficult for an individual to compute. Second, pension plans are usually "bundled" with other job provisions. A pension program is available only as an integral part of the employment contract rather than as an optional investment plan subject to individual adjustment. Thus, to change a pension plan, a worker frequently must change jobs. Third, IRS regulations reinforce the current system by making alternative schemes for retirement saving prohibitively costly. For most workers, an employer- or union-sponsored pension program is the only tax-advantaged saving plan available.

In restructuring these broader aspects of the pension system, a guiding principle should be to create a system where optimal freedom of choice in the selection of pension provisions can be exercised. Such flexibility would clearly benefit

both workers and employers. For workers attempting to accumulate pension savings, freedom means that pension coverage could be altered without the burden of changing jobs. As a result, business firms would capture some cost savings. With greater worker satisfaction and less work force turnover, hiring and training costs would decrease.[6] In addition, a greater range of pension options implies heightened competition among savings institutions as banks, pension plans, insurance companies, and other financial intermediaries compete for retirement savings. This would lead to efficient pricing for pension services.

Expanded freedom of choice should not be without limits. Great flexibility usually involves greater administrative and transition costs. Thus, the appropriate expansion of the choice horizon should be determined by a comparison between the incremental costs and benefits of the proposed changes. Whenever additional benefits outweigh the additional costs, the changes should be implemented.

One attractive method for expanding freedom of choice would be to make participation in all pension plans optional. The total value of each employee's combined wage package (including "employer contributions") should be explicitly and simply stated. Each worker could then periodically select his preferred mix of current and future income. However, each change in the mix of current earnings and retirement savings would require some administrative transaction that would not be costless. Hence some limit might be imposed on the frequency of change or a fee charged for the adjustment.

Workers should be free to choose the desired vesting, portability, and insurance provisions in their personal pension plans. Some workers might prefer to take all compensation in current wages, eschew the pension plan entirely, and use the services of other financial intermediaries (for example, mutual funds, insurance companies, and banks) to invest for retirement. A worker interested in 100 percent vesting and portability might fruitfully compare the pension plan with an investment in municipal bonds (another tax-free retirement plan if earnings are reinvested in similar securities) with conversion of the bond portfolio into taxable investments at retirement. However, a secure and satisfied worker could opt for delayed vesting and no portability to realize greater current wages.

The provisions of these proposals would allow private pensions to offer a tailored investment package to each employee. At the same time, private pensions would be forced to compete with other investment alternatives. However, substantial changes in the operation of the present system are necessary to redirect the pension system's focus. IRS regulations would have to be altered to allow workers to accumulate tax-free retirement investments. This option is presently available to self-employed individuals only. Concurrently, company-sponsored plans would be allowed to retain their tax-free status even though participation might fall to low levels. At present, about 80 percent participation is required for favorable tax treatment.

Some transition period is required to move from the present system to the proposed arrangement. Presently, many workers and retirees count on receiving benefits accrued through past service obligations. Most benefits actually paid from such obligations are funded on a current basis as a transfer from present workers, consumers or stockholders. An immediate change in the proposed system might have an effect similar to widespread terminations of

[6]It can be argued that unbundling pension provisions may increase work force turnover by "unlocking" employees from restrictive vesting and nonportability constraints. However, increased worker mobility does not necessarily mean firms will experience a massive employee exodus because satisfied workers will remain in their existing jobs. Moreover, an increased ability for workers to choose attractive jobs implies improved resource allocation in the economy. This should lead to greater economic efficiency with subsequent costs savings to firms.

private plans. The exit of substantial numbers of workers from existing company-sponsored plans to individual investment programs could drain funds from plans to such an extent that the payment of promised benefits would be impossible. Thus, mandated standards on funding which force private plans to become fully funded over a 30- to 40-year transition period are probably necessary.[7]

CAN IT BE DONE?

The proposed system is not unattainable. A large, private plan currently offers many of the proposed arrangements. The Teachers Insurance and Annuity Association and its companion College Retirement Equities Fund (TIAA-CREF) cover 350,000 educators at 2,500 participating institutions.[8] Individuals in TIAA-CREF have fully funded, vested, and portable (among participating institutions) pensions. Making such provisions generally available means more workers can participate in attractive and safe investment programs for retirement. Thus, the question of who gets what when would be answered by each individual's informed choice and conscious planning, not by fortuitous circumstance or benevolent charity. This should be the private pension system's goal.

[7]Ralph Nader and Kate Blackwell, *You and Your Pension* (New York: Grossman Publishers, 1973), pp. 164–65.

[8]*Business Week,* March 17, 1973, p. 51.

The Fed in Print

Business Review Topics, Fourth Quarter 1973, Selected by Doris Zimmermann

Articles appearing in the Federal Reserve Bulletin *and in the monthly reviews of the Federal Reserve banks during the fourth quarter of 1973 are included in this compilation. A cumulation of these entries covering the years 1970 to date is available upon request. If you wish to be put on the mailing list for the cumulation, write to the Publications Department, Federal Reserve Bank of Philadelphia.*

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"FOR THE RECORD . . ." Discontinued

"For the Record . . .", a regular feature on this page, has been discontinued. However, the types of data presented in the feature are now available in "Third District Economic Indicators," a statistical publication of the Federal Reserve Bank of Philadelphia.

"Third District Economic Indicators" may be received regularly and without charge by writing to the Statistical Services Division, Federal Reserve Bank of Philadelphia, Philadelphia, Pa. 19101 and requesting to be placed on its monthly mailing list.

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business review

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