Introductory Remarks

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This is the 16th of a series of conferences sponsored by the Federal Reserve Bank of Boston. In planning these conferences, our first objective has been to select a topic which we expect to be a prominent issue of public controversy in the years immediately ahead. The second is to bring together a small group of people with considerable expertise on the selected topic. The final objective is to publish the proceedings of the conference in order to provide a research base for future public policy decisions. The topic for this conference — the funding of pension plans, particularly public pensions — certainly satisfies all these criteria. We have no doubt that this will be a prominent issue of public policy for some years to come.

The papers prepared for this conference raise two fundamental issues — neither of which has received the public attention which it merits. The first is the massive change in the age structure of our population which raises serious questions as to the ability of future generations to finance public pension programs on a pay-as-you-go basis without levels of taxation which we, the drafters of the present programs, would consider intolerable. The second major issue is the impact of the underfunding of public pension plans on savings and capital formation.

The issue of the funding of pensions would not be as serious if the age structure of the population were reasonably stable over time. However, we know that the decline in the birth rate over the past two decades is going to produce a substantial decline in the ratio of the working age population to the total population in the years ahead. This fact raises serious questions as to the political viability of existing public pension programs if we continue to proceed on a pay-as-you-go basis.

The changing age structure also raises the question of intergenerational equity. Pay-as-you-go financing requires relatively low tax rates now and significantly higher rates in the future to accommodate the rise in the ratio of retirees to workers. A more equitable alternative may be to spread the required tax levy evenly over the generations by accumulating reserve funds now which could be used to pay benefits for future retirees.

There was a time when most economists accepted the doctrine that pension plans tended to increase the level of personal savings. I always found this doctrine difficult to accept, since it was inconsistent with my

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own behavior and that of those around me. This doctrine has been challenged in recent years by two of our participants, Martin Feldstein and Alicia Munnell. There is now a growing recognition that the spread of pension plans does reduce the level of personal savings. This reduction may be offset (or more than offset) by a higher level of institutional or governmental savings, if the pension plans are fully funded. However, if the level of personal savings declines, reflecting an assumption of enhanced personal security, and the pension funds are operated largely on a pay-as-you-go basis, the aggregate level of savings is reduced and, with it, the aggregate level of capital formation. The magnitude of the effect is suggested in Benjamin Friedman's paper in which he finds that a move to full funding of *all* public pension plans would generate such a massive increase in the level of aggregate savings that it probably could not be fully absorbed.

The conference will focus primarily on these two issues: the ability of future generations to finance the liabilities which we have not funded, and the impact of our failure to fund public pension plans on the aggregate level of savings and capital formation. These issues are likely to have a prominent place on the public agenda for a good many years to come.