Legislative Retirement Study Commission
Monday, March 12, 1973
Room 15, 7:00 P.M.

Minutes

The chairman, Sen. Chenoweth, opened the meeting.

PRESENT:

Senators	Representatives
John Chenoweth	Richard Parish
Harmon Ogdahl	Donald Moe
Mel Hansen	Cal Larson
Eugene Stokowski	Al Patton
Jack Kleinbaum	Robert Johnson

The chairman introduced Dr. Francis Boddy, University of Minnesota and chairman of the Governor's Advisory Committee. (exerpts from Dr. Boddy's address attached).

Dr. Franklin Smith, actuary for the Commission, presented the following memos and fund valuation:

GVS 72-14 - Salary Scales and Across the Board Salary Increases.

Discussion:
Chenoweth: On salary and interest assumptions, what is the experience in terms of private corporations you are dealing with? What is the experience you have and what kind of figures are you working with on different plans?

Dr. Smith: 5% interest assumption for the private plans. On salary assumptions, depends on final average salary plan; most will not introduce that element. On final salary plans, we are using standard tables assumptions of about 6 to 7% salary increase in ages 25 to 30; and tapers off to around ages 55 to 60 level. Strictly longevity increases--1% for older employees and 6% for those under 35 years.

Question: What would be the average?

Dr. Smith: Ballpark guess would be 3 1/2%.

Chenoweth: Re other public funds, what interest and salary assumptions are being used?

Dr. Smith: Interest assumption - 4 1/2% to 5%.

Sen. Ogdahl pointed out that Chapter 356 was enacted for the purpose of standardizing a reporting basis for all funds for comparison purposes.

GVS 67-2 - Methods of Recognizing Unrealized Appreciation and Depreciation of

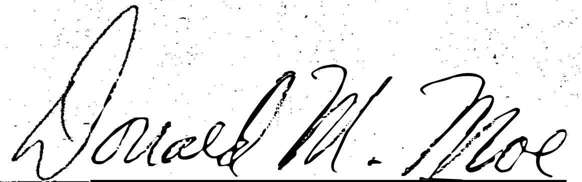
Equities Held by Pension Funds.

GVS 72-12 - Final Salary Benefit Formulas vs Career Average Formulas; Cost Comparisons.

The following memos were distributed. They were not gone over by Dr. Smith:

Valuation of the Twin City Lines as of January 1, 1971
Valuation of the St. Paul Bureau of Health as of December 31, 1972.

Meeting adjourned at 9:30 P.M.



Donald M. Moe
Secretary

E. Diebel, Steno

Dr. Francis Boddy - Talk before the Legislative Retirement Study Commission on March 12, 1973 (Exerpts)

1. What will the interest rate pattern be like in the future?

2. What will the salary be like for those people in the fund?

For capital gains, it is much better to have the stock go up and increase in value rather than get the dividends.

When interest rates tend to be high one of the reasons may be inflation.

Unhappy conclusion--not quite sure that price stability and employment can be maintained at the same time.

Interest rates depend on policies of the rest of the world.

Salaries and raises are going to depend on how successful we are in holding down inflation and also how close to full employment we get. We haven't found the successful formula yet. It's a policy decision--how to figure this out. Policy decision is going to be made by the current legislature in the next three years. It does seem that the aim to hold down inflation is going to be looser.

We can hold down inflation if we are willing to accept a higher rate of unemployment. Politically, it's not a profitable decision.

As to monetary control--raising loans, raising interest rates--may slow down inflation at the expense of very high interest rates. Less unemployment and more inflation.

We will in the near future and in the longer pull have substantially higher interest rates than we have had in the past.

Salary increases may or may not keep pace with the cost of living increases. Salaries may be higher than the rate of inflation.

You may suspect that salaries should increase by the cost of living.

The future will look something like the past. We will have something like a 2 1/2% per year increase in productivity; 4% inflation--(6 1/2% in wages plus productivity).

We will have fairly substantial inflation, more than the relatively low rates we had in the 1950's--perhaps 3 1/2%; 2 1/2% productivity--6% wage increase across the board. In higher education, we will get less than that. State and local government salaries are going to rise more than higher education did. Problems are in state and local government. The average family income in the U.S., individuals as well, increased almost exactly 50% in real terms in the last 15 years. In 1985, average family income may be $15,000 and will demand $15,000 type retirements.

Interest rates and salaries get into the system in two ways. You are accumulating a fund and if you pay into the fund for 40 years, there is in that fund an accumulation of X dollars and for which you will buy an annuity for the rest of your life. Interest rate determines how much there will be in there at the end. $1.00 a year for 40 years at 3% you have $75 to buy your annuity with; $1.00 per year at 5%, you will have $121 .....

Discussion:

Chenoweth: In your opinion, when we talk about the increase in the cost of living, salary and interest rates, and we get into different periods of inflation as indicated .... is there any relationship as to what they will do?

Dr. Boddy: Future is only relatively predictable. We will have increases in inflation and increases in productivity. Interst rates will be high because at least one of the sources is savings; and if people think inflation is going to be 10% a year, better to buy something that will go up rather than put into the bank. Interest rates will have to be over 5%. If they think it's going to increase each year 5%, then they will demand 7% (and I think they would). Interest rates will be more than the rate of inflation.

Chenoweth: Take a 4 1/2% inflation, realistically, there would be a 2% rate of return on real money. Would you assume 6 1/2% on interest rates? Corporate bonds are already above 7%; stock market was over 9%. Exclude corporate bonds and treasury bônds.

Dr. Boddy: What kind of return with that kind of inflation would you anticipate -- 8% conservatively.

Cal Larson: What did you say would be a fair assumption as far as salary is concerned?

Dr. Boddy: Across the board wages and salaries would be about 2 1/2% higher.

Cal Larson: Interest rates and salary assumptions would be fairly close?

Dr. Boddy: Talking about the government element--local government--for state employees, try to find some relation between what might be assumed to be a true interest rate, including above the prime rate of whatever we need in the .... terms. What would be the inflationary pattern re teachers, would it be less than 3 or 4%? If teachers keep up with inflation, they will be doing very well.

Excluding teachers and come to public employees ....

Dr. Boddy: Will follow along the national average--clerical rates of increase, starting in 1961 to 1962--2.8%; 1970 to 1971--6.5%; 1971 to 1972--5.6%.

Dr. Boddy: Rate of interest and rate of salary would be the same without inflation. In 1959, rate of inflation was only 1%.

Chenoweth: 1968 to 1972 ...... average of 8% in our total investments.

Cal Larson: Would you look at the last 15 years salaries and see what the picture looked like?

Dr. Boddy: If it goes up very fast and then slackens off, it would continue to slacken off. Look at the particular kind of groups you will be working with for about 15 years. State and local people will be in somewhat general demand. Get an average of all these funds with 15 years experience and that would be a basis for this commission to look at this matter even further.

Moe: You think that salaries are going to increase at 6 1/2%

Dr. Boddy: Inflation over the last 10 years was 3 1/2%, productivity 2 1/2%--6%.