Glass, M. R. and Vanatta, S. H. (2021) The frail bonds of liberalism: pensions, schools, and the unraveling of fiscal mutualism in postwar New York. *Capitalism: A Journal of History and Economics*, 2(2), pp. 427-472.

(doi: 10.1353/cap.2021.0009)

This is the Author Accepted Manuscript.

There may be differences between this version and the published version. You are advised to consult the publisher's version if you wish to cite from it.

http://eprints.gla.ac.uk/222115/

Deposited on: 13 August 2020

Enlighten – Research publications by members of the University of Glasgow
http://eprints.gla.ac.uk

The Frail Bonds of Liberalism: Pensions, Schools, and the Unraveling of Fiscal Mutualism in Postwar New York*

Michael R. Glass, Princeton University
Sean H. Vanatta, New York University

Between 1940 and 1965, state-level officials changed the relationship between two pillars of the postwar social contract: secure retirement and modern public schools. In the early twentieth century, state pension managers, following an investment regime we call "fiscal mutualism," funneled the savings of government workers into government securities. Through direct participation in municipal bond markets, pension officials lowered the borrowing costs for local governments. Yet by the 1960s, pensions had completely abandoned this investment regime. We document this transformation through a close examination of New York State's pension fund. Throughout the 1950s, the comptrollers who managed the New York State Employee Retirement System (NYSERS), the nation's largest state pension, underwrote the boom in suburban school construction by purchasing the municipal bonds of local school districts. However, in response to changes in national political economy, along with shifts in the ideology guiding pension stewardship, New York Comptroller Arthur Levitt Sr. sought to deregulate the pension's investment powers. Following the regulatory changes, Levitt disinvested from municipal bond holdings in favor of higher-yielding corporate securities. Pension deregulation secured higher returns for state retirees, but it also forced local school districts to enter bond markets without the backstop of fiscal mutualism. As school budgets, and the property taxes supporting them, soared to repay the interest costs, tax revolts became a permanent response to the fiscal volatility. These transformations, we argue, stemmed from postwar liberalism's dependence on financial markets to deliver retirement security, public education, and other social benefits. This public dependence on private capital foreclosed more ambitious policy alternatives and ceded power to private actors—particularly investment bankers and bond investors—who prioritized their own profits over social welfare provision.

* This essay began as a chance conversation in Firestone Library and has evolved into its present form through the encouragement, engagement, and critique of numerous colleagues and friends. We would like to thank Teal Arcadi, Jacqueline Brandon, Brent Cebul, Peter Conti-Brown, Erin Cully, Esther Cyna, Andrew Edwards, Paige Glotzer, Dylan Gottlieb, Eric Hilt, Nick Juravich, Tim Keogh, Rob Konkel, Kevin Kruse, Jon Levy, Julia Ott, Kim Phillips-Fein, Mason Williams, Julian Zelizer, as well as audiences at the Columbia Economic History Seminar, the NYU History of Education Writing Group, and the Business History Conference. A special thank you to Jim Folts and the rest of the staff at the New York State Archives.

In May 1959, New York State Comptroller Arthur Levitt Sr. met with a group of financial executives at the downtown office of Goldman Sachs & Company. This was the first meeting of the new Investment Advisory Council, which Levitt had assembled to help transform the state's $1.2 billion retirement portfolio. With the bankers' encouragement, he planned to sell the pension's extensive municipal bond holdings and to reinvest the receipts into higher-yielding private mortgages and corporate securities. The sell-off would have far-reaching consequences for school districts across the state. Over the previous decade, New York comptrollers had subsidized public school construction by purchasing school bonds with pension funds. Following his advisers' counsel, Levitt would disinvest the New York State Employee Retirement System from municipal bonds, shifting the investment strategy from using pension funds to subsidize public infrastructure to seeking maximum yield for state retirees in private capital markets.[1]

The meeting thus marked a decisive change in priorities. Under the previous investment regime, which we call *fiscal mutualism*, state officials funneled pension savings into local governmental securities, using these investments to underwrite infrastructure costs. Of course, such recycling of public funds into local development was an enduring feature of United States political economy. With devices like publicly owned corporations and sinking funds, government officials had long used state assets to enhance state capacity. But over the twentieth century, as retirement systems accumulated the savings of government workers, pensions became an especially powerful tool for advancing public objectives. By the 1940s, pension trustees oversaw funds greater than those managed by all but the largest corporate firms, and they used this robust buying power to lower borrowing costs for state and local governments. By purchasing municipal bonds, public pensions indirectly subsidized the construction of roads, sewers, schools, and other infrastructure projects that depended on bond markets for capital financing. These investments, moreover, provided pensioners with safe, consistent returns for their retirement accounts. The political and economic logics of fiscal mutualism reinforced one another, and this was by design. Before World War II, nearly every state legally restricted public pension investments to federal, state, and local bonds.[2]

A governing practice rooted in federalist institutions, fiscal mutualism became essential to liberal statebuilding during the postwar era. At the national level, policymakers crafted "grand expectations" for abundant lifestyles, but they delegated the implementation to local

[1] New York State Department of Audit and Control Correspondence, Speech, and Report Files (hereafter: Levitt files), New York State Archives (hereafter: NYSA), Minutes, Meeting of Comptroller's Investment Advisory Council, May 27, 1959 and May 6, 1960, "Retirement—Investment Adv. Comm." folder, box 3.

[2] For an overview of state-led development, see Scheiber, "Government and the Economy." For the state pension figures, see Andrews, "Retirement Funds in the Financial Structure."

governments and the bond markets they depended upon. School construction, a quintessentially local function, is a case in point. While federal policies insured home mortgages and funded interstate highways, propelling citizens to the metropolitan periphery, they left local governments responsible for public services in new suburbs like Levittown, New York. The costliest of these, public education, became a "mandate without money" that stretched the fiscal capacity of suburban districts. State officials initially met the school-building crisis by turning to pension funds. During the 1950s, New York comptrollers purchased school bonds to subsidize school construction, leveraging the market power of pension systems to hold down interest rates. Fiscal mutualism helped turn the lofty promises of suburbia into concrete realities.[3]

But changes in national political economy, along with shifts in the ideology guiding pension stewardship, spelled the downfall of fiscal mutualism. During World War II, the combination of rising federal tax rates and backlogged infrastructure caused the yields of tax-exempt municipal bonds to decline relative to taxable private securities. By 1945, municipal bonds offered less than half the returns of similar corporate securities. In this context, the interests of schools and pensions diverged: whereas school districts sought the lowest possible interest rates on their bond issues, pensioners sought the highest possible yields for their retirement accounts. As Levitt complained to the Investment Advisory Council in 1959, the dual obligations of the comptroller—to local governments, as the state's chief fiscal officer, and to retirees, as the trustee of their pensions—presented him with "perplexing questions of policy." Levitt and other pension managers resolved this dilemma through the framework of "fiduciary duty," a legal concept that evolved in the postwar era to prioritize maximum returns over absolute safety. Across the country, state officials lobbied for the deregulation of public pensions, enabling pension managers to abandon local investment in favor of higher-yielding corporate securities. Whereas in 1942 state and local bonds comprised 70 percent of all state pension assets nationwide, by 1957 the figure had dropped to 19 percent. By 1972, it was less than 1 percent. In state after state, fiduciary duty overrode the mutual obligations of local investment, unraveling the regime of fiscal mutualism.[4]

---

[3] Patterson, *Grand Expectations*. Studies that document the federal underwriting of suburbia rarely address infrastructure finance. See Jackson, *Crabgrass Frontier*; Cohen, *Consumer's Republic*; Freund, *Colored Property*. For an exception, see Rome, *Bulldozer in the Countryside*, esp. 87-118. On "mandates without money," see Derthick, *Keeping the Compound Republic*, 43-55.

[4] Levitt files, Minutes, Meeting of Comptroller's Investment Advisory Council, May 27, 1959, "Retirement—Investment Adv. Comm." folder, box 3; Andrews, "Retirement Funds in the Financial Structure," 411-414; Tilove, *Public Employee Pension Funds*, 204-205. On the rise of the federal tax state, see Sparrow, *Warfare State*. On the 1950s deregulation of pensions, see McCarthy, *Dismantling Solidarity*. The decline of fiscal mutualism runs parallel to, but is distinct from, the political conflicts over private pensions McCarthy documents, because public pensions were in the hands of fiduciaries from their inception and public-sector unions only became powerful in the 1960s, after the transition toward what McCarthy calls the financialization of the pension system was well underway.

In charting the rise and fall of fiscal mutualism, this article examines an underappreciated transition in how government officials delivered two key pillars of the postwar social contract: secure retirement and modern public schools. This offers a new perspective on the conflicts over public and private welfare provision at the heart of liberal statecraft. In modern America, citizenship carried expectations of rising wages, subsidized homeownership, a lifestyle of bountiful consumption, and economic security in old age. To be sure, these privileges were only fully available to white male breadwinners, and scholars have analyzed how entire groups were excluded on the basis of gender, race, and sexuality. Still, less attention has been paid to the mechanisms that actually delivered those social benefits. With its fusion of state pensions and local infrastructure, fiscal mutualism reveals how liberal state-builders, when faced with the structural constraints of federalism, relied on market mechanisms to allocate benefits. Indeed, fiscal mutualism made use of markets; it did not supplant them. Although pensions were never the only buyer of municipal bonds, comptrollers acted decisively in bond markets, using them as a private means to support the public ends of school construction. Comptrollers wielded the purchasing power of pension funds to hold down school bond interest rates. In this way, they helped fulfill the grand expectations of postwar liberalism, albeit *through* markets.[5]

Like transportation, housing, healthcare, and other components of the mixed welfare state in the United States, pensions and schools were delivered through public-private partnerships. At first glance, the underwriting of school construction with pension funds might seem to demonstrate the effectiveness of what historian Brian Balogh calls "the associational order," through which officials appealed "to the logic of the market, even as they expanded the state's capacity to shape that market." But this associational order was far more precarious than Balogh suggests. As we show, its dependence on markets ceded inordinate power to private actors, like the investment bankers at Goldman Sachs, who prioritized their own profits over social welfare provision. Furthermore, not all citizens benefited equally from these arrangements. When municipal bonds yields stagnated in the 1950s, pension managers followed a market logic, abandoning municipal bonds in search of higher returns. As a result, state pensioners reaped higher yields on their retirement accounts, but local governments suffered

[5] For a useful theorization of governments as market actors, see Hockett and Omarova, "'Private' Means to 'Public' Ends." For historical studies on the role of markets in American state development, see Brinkley, *End of Reform*; Balogh, *Government Out of Sight*; Radford, *Rise of the Public Authority*; Cebul, "Creative Competition." On the blended, federalist structure of the American welfare state, see Hacker, *Divided Welfare State*; Klein, *For All These Rights*; Cebul, Tani, and Williams, "Clio and the Compound Republic." On group-based welfare state exclusions, see Kessler-Harris, *In Pursuit of Equity*; Katznelson, *When Affirmative Action Was White*; Canaday, *Straight State*.

higher debt service costs. In short, state retirees benefited at the expense of local school districts.[6]

The unraveling of fiscal mutualism had immediate consequences. Taxpayers in suburban districts paid for their exposure to the bond market with higher tax rates, driven in part by rising interest rates on municipal bonds. A direct response to the public dependence on private capital, school tax revolts, like the one that rocked New York in May 1959, became a permanent feature of suburban politics. While scholars have depicted suburban tax revolts as either a backlash against racial liberalism or a crusade to restore informal tax privileges, we show that many suburbanites turned against the liberal state in response to its fiscal volatility during the seemingly prosperous 1950s. To insulate districts from rising interest costs, New York lawmakers dramatically increased their state aid allocations. This promise, however, redirected anger at the state itself, setting the stage for even larger tax revolts in subsequent decades.[7]

In what follows, we examine postwar liberalism from the perspective of the comptroller's desk. We begin by outlining the early twentieth century regime of fiscal mutualism, before showing how the suburban school construction crisis stretched this regime to its breaking point. From there, we examine the investment decisions of various New York comptrollers as they attempted to balance the competing demands of pensions and schools. Faced with these diverging interests, Levitt followed the lead of other pension managers and began lobbying for deregulation. In the concluding sections we trace the consequences of pension deregulation for retirees, school districts, and the fate of liberalism more broadly. Levitt did continue seeking liberal policy priorities, and state pensioners did benefit from higher returns. The tradeoff was that states—and the State of New York, in particular—abandoned their direct role in shaping the bond market, leaving municipal borrowers to navigate the market on their own.

The Political and Economic Logics of Fiscal Mutualism

The New York State Employee Retirement System (NYSERS) emerged from efforts by Progressive Era reformers to provide civic employees with guaranteed retirement security. The state legislature created NYSERS in 1920 to replace a patchwork of state and municipal pension schemes, organizing the fund on an actuarial reserve basis. Public employee unions were still in their infancy, and the political conflicts initially centered on whether workers or governments would pay the pension contributions, not over the investment returns. The state accumulated

---

[6] Balogh, *Associational State*, 139. For a comparative perspective on the mixed welfare state, see Offner, *Sorting Out the Mixed Economy*.

[7] "Taxpayer Revolt Seen in L. I. Votes," *New York Times*, May 8, 1959, p. 18. For these interpretations of the 1970s tax revolts, see Self, *American Babylon*; Martin, *Permanent Tax Revolt*.

matching employee and government-employer contributions, which the comptroller held in trust. The law guaranteed state employees—stenographers and civil engineers, social workers and claims examiners—a fixed return on their contributions, initially 4 percent annually. In years when the investments did not reach the yield threshold, state and local governments were required to make "deficiency payments" to cover the difference. Although the actuarial math was complicated, policymakers aimed to provide retirees with approximately half-salary at age sixty. This guarantee became more substantial following a 1938 state constitutional amendment mandating that pension benefits, once established, could not be abridged.[8]

Following regulations common to most public pensions, the comptroller invested the funds within a set of rules designed to encourage financial safety and subsidize local infrastructure. In the 1920s, New York law limited NYSERS's holdings to U.S. government securities and the debt obligations of the state and its political subdivisions. Within these limits, comptrollers invested almost entirely in municipal bonds. Morris S. Tremaine, comptroller from 1927 to 1941, described this strategy in his 1929 *Annual Report*: "I have continued the policy…of investing largely in the bonds of the municipalities of New York State," he wrote, "assisting them in procuring funds for needed improvements at a fair rate of interest when their financial condition warrants their borrowing." As the state's chief fiscal officer, Tremaine used his investment authority to support the municipal bond market while also supervising the borrowing governments. Fiscal mutualism had, in this sense, a deeply political logic: it provided state officers with levers of control over smaller units in the federalist political structure.[9]

Crucially, fiscal mutualism was never intended as an employment stimulus. Pension managers needed secure outlets for pension investments. Municipal bonds met this need, while also allowing comptrollers to support public projects. In other words, comptrollers did not purchase municipal bonds to create jobs for public sector workers. As Tremaine indicated, he stood ready to support local borrowing only when that support was "needed." Public pensions did not actively encourage infrastructure development; rather, state officials used pension funds to hold down the interest costs of infrastructure projects already underway. Fiscal mutualism

[8] Clark, Craig, and Wilson, *History of Public Sector Pensions*, 167-202; State of New York, *Report of the Commission on Pensions*, Legislative Document No. 92 (Albany, 1920); Tilove, *Public Employee Pension Funds*, 290. On the origins of public pensions, see Clark, Craig, and Wilson, *History of Public Sector Pensions* and Sterett, *Public Pensions*. On public-sector unionization, see Slater, *Public Workers*; McCartin, "'A Wagner Act for Public Employees'."

[9] Clark, Craig, and Wilson, *History of Public Sector Pensions*, 203-217; Calvert, *State Pension Funds*; New York State Comptroller's Office, *Annual Report of the Comptroller* (1930), xvii. Following *King v. Talbot*, 40 NY 76 (1869), New York restricted trustees to a "legal list" of investments. The legal list operated in distinction to the "prudent man rule," developed earlier in Massachusetts, *Harvard College v. Armory*, 26 Mass. (9 Pick.) 446 (1830). For useful overviews of this shift, see Stevenson, "Why the Prudent Man"; Sligh and Taylor, "Statutory Note: Trustee Investment—Legal List."

was, in this sense, pre-Keynesian and associational, a mode of state fiscal governance that appealed to traditions of limited government and market discipline.[10]

For state officials across the country, a shared ideology of prudential investment reinforced the political logic of fiscal mutualism. Through the end of World War II, state pension managers prioritized safe returns over maximum yields. They developed this ideology through professional organizations such as the Municipal Finance Officers Association, and its journal, *Municipal Finance*, where public officials and private financiers both defended the efficacy of municipal bond investments. Pension beneficiaries "are the public officers and employees who can largely influence the fiscal policies of the debtor municipality," argued New York investment banker Cushman McGee in 1944. "Having a personal interest in the financial integrity of the municipality," he continued, "they will exert themselves toward the maintenance of its credit record so that it will pay its bonds." For McGee and others concerned with pension policy, "security of principal" remained the primary objective. Fiscal mutualism secured the investments by creating layers of reciprocal obligation. Within this framework, pension trustees funneled pension funds into state and local securities, which comprised 70 percent of public pension assets nationwide in 1942, and 86 percent of those held by NYSERS.[11]

For all its political and economic advantages, fiscal mutualism contained a built-in vulnerability. Because municipal bond interest payments are exempt from federal taxation—a feature codified with the establishment of the federal income tax in 1913—they consistently offer lower yields than similarly risky private securities. Investors and corporations subject to federal income taxes are compensated for these lower yields with tax savings. The effective tax rate is thus a prime determinant of the yield ratio of taxable to non-taxable securities. Public pensions, however, are not taxed, meaning the tax benefits of municipal bonds do not accrue to pensioners. Before the 1940s, bond market conditions, coupled with low federal tax rates, kept the yield differential relatively modest. By itself, the slight differential was not enough to undermine the reciprocal obligations of fiscal mutualism.[12]

Nevertheless, the economic catastrophe of the Great Depression drove down municipal bond yields—both absolutely, and in relation to similarly risky corporate securities—straining

---

[10] Certainly, the case can be made that by holding down borrowing costs for local governments, fiscal mutualism encouraged infrastructure building at the margin, acting as an employment stimulus whether comptrollers intended it as such or not.

[11] Clark, Craig, and Wilson, *History of Public Sector Pensions*, 203-217; Meriam, *Principals Governing the Retirement of Public Employees*, 101-102, 348, 354, 434-437; McGee, "Investments of Retirement Systems," 17; Andrews, "Retirement Funds in the Financial Structure," 411-414; *Annual Report of the Comptroller* (1941), Vol. II, 86-88.

[12] Robinson, *Postwar Market for State and Local Government Securities*, 3-4, 7-9; Homer, "Factors Determining Municipal Bond Yields," 269-298; Romer and Romer, "Incentive Effects of Marginal Tax Rates," 278-279; Clark, Craig, and Wilson, *History of Public Sector Pensions*, 205, 212.

the symbiotic relationship between state investors and local borrowers. In New York, the state's portfolio of local bonds had consistently returned around 4.5 percent through the early 1930s, allowing the comptroller to invest in local municipal bonds while still maintaining the state's 4 percent guarantee to pensioners. But as municipal bond yields declined, from a nationwide average of 4.3 percent on high-grade issues during the 1920s to 3.36 percent in the 1930s, state officials recognized that the retirement system's 4 percent guarantee could no longer be maintained with municipal investments alone. "We could foresee almost the exact day when the average yield would drop below the interest rate paid on member contributions," Tremaine observed in 1934, as he urged the legislature to liberalize his investment powers. In 1936, state lawmakers authorized NYSERS to invest in mortgages insured by the Federal Housing Administration (FHA), which Tremaine began purchasing the following year. The surge in racially exclusive housing development, underwritten by the federal government with FHA-insured mortgages, offered sufficient returns for Tremaine to meet the guarantee to retirees. Even with these new investments, Tremaine kept using state funds to promote local development, limiting mortgage purchases to "property located within the state."[13]

The bright spot of mortgage investments only lasted until the mobilization for World War II demanded a greater share of financial resources. As the war progressed, New York comptrollers shifted pension assets into U.S. Treasury securities, which offered both higher yields and the opportunity to maintain investments in state capacity, now with a national rather than a local emphasis. Federal bonds shot up from 1 percent of the NYSERS portfolio in 1942 to 20 percent by 1944, a trend matched on the national level, where pension holdings of federal bonds rose from 16 percent in 1942 to 35 percent in 1944. At the same time, New York lawmakers, in 1943, lowered the pension interest guarantee on future contributions from 4 percent to 3 percent, since higher investment yields no longer seemed attainable.[14]

Although pension managers looked hopefully to the postwar era, when delayed infrastructure projects would generate new outlets for local investment, the demands of war finance had fundamentally challenged the economics of fiscal mutualism. During the war, Congress instituted mass income taxation, which significantly hiked the rates paid by the

---

[13] Homer, "Factors Determining Municipal Bond Yields," 277-279, 294-295; *Annual Report of the Comptroller* (1935), xx, 290-300; *Annual Report of the Comptroller* (1937), xxi, 292; Tremaine, "New York's FHA Mortgage Investments," 3-4; "State Funds Used For Insured Loans," *New York Times*, Feb. 12, 1939, p. 149; New York Session Laws (1936), Ch. 354, p. 719-723; Ch. 717, p. 1579-1580; Ch. 805, p. 1705. On the white supremacist administration of the FHA, see Freund, *Colored Property*; Glotzer, *How the Suburbs Were Segregated*. On how the Depression changed trustee investment, see Grosh, "Trustee Investment: English Law and the American Prudent Man Rule."

[14] Homer, "Factors Determining Municipal Bond Yields," 295; *Annual Report of the Comptroller*, 2 vols. (1941), 2:1; Andrews, "Retirement Funds in the Financial Structure," 414, 531; *Annual Report of the Comptroller*, 2 vols. (1944), 2:1-2.

nation's highest earners. The new tax regime widened the gap between taxable and non-taxable securities. At the peak in 1945, the average high-grade municipal bond yielded just 1.2 percent annually, a mere 41 percent of similar corporates securities. Although the gap would later narrow, to about 75 percent by 1953, it would never close entirely. Meanwhile, into the 1950s, municipal yields remained stubbornly below 2 percent. These low rates still appealed to investors in the highest tax brackets but were far below state guarantees to pensioners.[15]

As a result of the widening yield gap, public pension trustees began shifting away from municipal bonds, and, where authorized to do so, started buying non-governmental securities. In New York, the comptroller returned to purchasing FHA mortgages, expanding NYSERS holdings from less than 4 percent of the portfolio in 1948 to over 20 percent in 1951. Over the same period, non-governmental securities—primarily corporate bonds, but also mortgages, stocks, and other private investments—jumped from 6 percent to 14 percent of nationwide pension assets, beginning a trajectory that would accelerate in subsequent decades.[16]

The same low interest rates that made municipal bonds unappealing for pension funds encouraged state and local governments to borrow, building widespread expectations for postwar prosperity underwritten by cheap credit. Here, the demands of war finance also played a decisive role. Throughout the conflict, the Federal Reserve, in concert with the Treasury Department, held down interest rates to support the market for federal securities. After the war, with inflation increasing as public and private borrowers competed for credit, the Federal Reserve finally extricated itself from the Treasury's grasp in March 1951. In the wake of this "Fed-Treasury Accord," the Federal Reserve reasserted its authority over inflation by deliberately hiking interest rates. As the Fed started to battle inflation in earnest, the cost of municipal borrowing increased, threatening the grand expectations for postwar prosperity.[17]

In sum, the war had disrupted the *economic* logic of fiscal mutualism on two fronts. First, absolute municipal yields fell below the state guarantees. Second, municipal yields declined relative to comparable corporate securities. Although a rush of government borrowing would eventually drive municipal yields back up, thus narrowing the yield gap, the ratio of municipal to corporate yields remained below 80 percent through the 1950s. Still, the *political* logic of fiscal mutualism remained sound; in fact, it grew stronger as the postwar boom collided with higher borrowing costs. Public pensions continued to invest in local infrastructure,

---

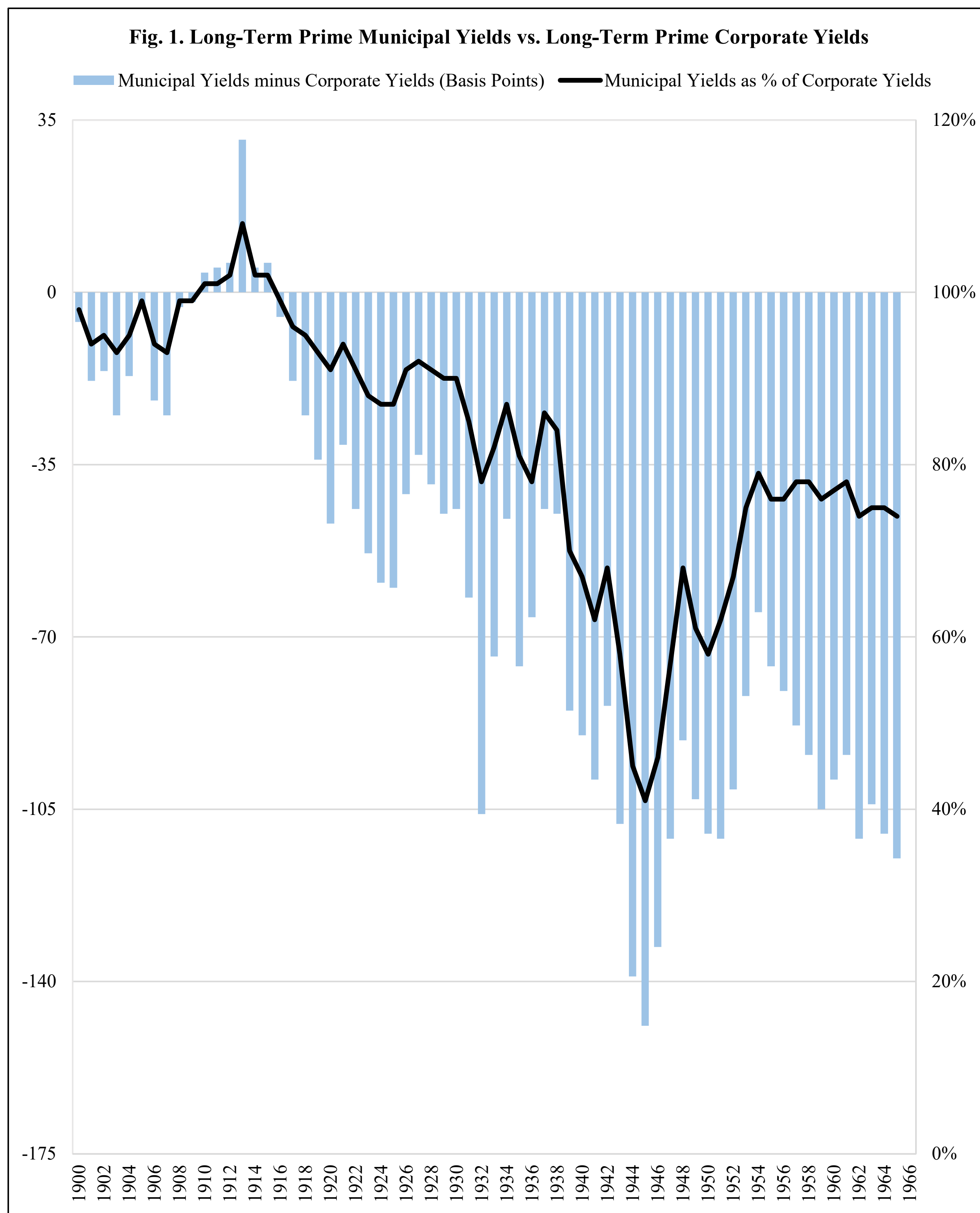
[15] Homer, "Factors Determining Municipal Bond Yields," 279-282, 294-296. On mass income taxation, see Sparrow, *Warfare State*.

[16] Clark, Craig, and Wilson, *History of Public Sector Pensions*, 209; *Annual Report of the Comptroller*, 2 vols. (1942), 2:1; *Annual Report of the Comptroller*, 2 vols. (1943), 2:1; *Annual Report of the Comptroller* (1945), 13; *Annual Report of the Comptroller* (1946), 12; Andrews, "Retirement Funds in the Financial Structure," 415, 432-436, 530; *Annual Report of the Comptroller* (1948), 98; *Annual Report of the Comptroller* (1951), 95.

[17] Friedman and Schwartz, *Monetary History of the United States*, 593-638, passim.

maintaining a sizeable share of the municipal bond market nationwide. But the shock of the war mobilization had displaced fiscal mutualism as the conventional wisdom. In its place emerged new ideas emphasizing maximum yields over safe returns.[18]

[18] Andrews, "Retirement Funds in the Financial Structure," 489-492.



Source: Homer, “Factors Determining Municipal Bond Yields,” 296.

Envelopes

A crucial, though overlooked, step in building a new school involved a pile of envelopes. On a Thursday morning in November 1956, the seven members of the Levittown Board of Education gathered around a conference table. For local government officials, this was what the municipal bond market looked like: a table filled with sealed envelopes, each one labeled "Proposal for Bonds" and carrying return addresses from Wall Street investment banks. In several referendum votes, Levittown taxpayers had authorized $5.5 million in bond issues, which would pay for a new high school and three elementary schools to accommodate the suburb's rapidly growing population. Architects had drawn the blueprints, politicians had broken ground, and construction had already begun. But until those envelopes were opened, the district would not have the funds to pay the mounting bills. When the board members simultaneously unsealed all of the envelopes, the lowest bid was for a jaw-dropping 4.3 percent interest.[19]

The winning bid in Levittown was the highest rate for any school bond sold in New York that year. Just four years earlier, in 1952, the district had sold a $2.4 million school bond issue for 2.7 percent interest. That slight difference in rates—between 2.7 percent in 1952 and 4.3 percent in 1956—meant that, over the course of the thirty-year loan, Levittown taxpayers would have to pay an additional $1.4 million just on interest payments, the equivalent of a 900-pupil elementary school. For Levittown and other rapidly growing municipalities across the country, rising interest rates were a slow-motion disaster.[20]

The postwar decade witnessed a flurry of new school construction, as rising birth rates and higher graduation rates stretched the nation's schooling capacity. The problems, however, were most acute in greenfield suburbs where young white families, channeled by federal mortgage guarantees, rushed into new subdivisions. Between 1948 and 1953, the number of school-age children doubled in Nassau County, the Long Island county just east of New York City. "Phenomenal growth" in suburban areas, warned the State Education Department, had created "one of the most serious school housing problems of our time." Political fragmentation compounded the strain: Nassau County alone contained fifty-six separate districts, and each one had to manage the suburban boom independently.[21]

---

[19] "Levittown Plans A $5,554,000 Issue," *New York Times*, Nov. 8, 1956, p. 60; Municipal Finance Commission, *Local Finance Law*, 20-21.

[20] "School Bond Sales, New York State, Oct. 1956-March 1957," in *Federal Aid to States for School Construction*, 85 Cong. 1189 (1957); "Interest Rise Deters School Building: Ave," *Newsday*, Dec. 4, 1956, p. 38.

[21] New York State Education Department, *Forty-Eighth Annual Report* (1955), 41; Val Duncan, "LI Schools Face Teacher Shortage, Overcrowding," *Newsday,* Sep. 3, 1953, p. 44.

Interest exempt from all present Federal and New York State Income Taxation.

$5,554,000

Union Free School District No. 5 of the Town of Hempstead, New York

4.30% Bonds

Due serially May 1, 1957 to 1986, inclusive

Legal Investment, in our opinion, for Savings Banks and Trust Funds in New York

These Bonds, to be issued for school purposes, in the opinion of counsel will constitute valid and legally binding obligations of Union Free School District No. 5, payable from ad valorem taxes levied against all the taxable real property therein without limitation as to rate or amount.

Amount	Maturity	Yield	Amount	Maturity	Yield
$969,000	1957-62	Not Reoffered	$ 860,000	1970-73	4.05%
515,000	1963-65	3.95%	860,000	1974-77	4.10
710,000	1966-69	4.00	1,640,000	1978-86	4.15

(accrued interest to be added)

These Bonds are offered when, as and if issued and received by us and subject to approval of legality by counsel, whose opinion will be furnished upon delivery. The offering circular may be obtained in any State in which this announcement is circulated from only such of the undersigned and other dealers as may lawfully offer these securities in such State.

HALSEY, STUART & CO. INC.
SALOMON BROS. & HUTZLER
GEO. B. GIBBONS & COMPANY INCORPORATED
R. W. PRESSPRICH & CO.
ROOSEVELT & CROSS INCORPORATED
ADAMS, McENTEE & CO., INC.
BACON, STEVENSON & CO.
HORNBLOWER & WEEKS
BLAIR & CO. INCORPORATED
CHAS. E. WEIGOLD & CO. INCORPORATED
BACHE & CO.
PAINE, WEBBER, JACKSON & CURTIS
FRANCIS I. duPONT & CO.
COFFIN & BURR INCORPORATED
FIRST OF MICHIGAN CORPORATION
R. D. WHITE & COMPANY
TILNEY AND COMPANY

November 16 1956

Fig. 2. **Levittown school bond advertisement**.
Source: *Wall Street Journal*, Nov. 16, 1956, 16.

Levittown remains an infamous example of the exclusionary policies and practices that walled off new suburbs for whites only. The builders, Levitt & Sons, inserted restrictive covenants into every deed, prohibiting occupancy "by any person other than members of the Caucasian race." Even though the Supreme Court ruled in *Shelley v. Kraemer* (1948) that racial covenants were judicially unenforceable and the FHA expunged the explicit racial references from its *Underwriting Manual*, the exclusionary practices continued. After federal officials approved the mortgage insurance for Levittown's houses, many African American veterans waited in line to purchase an affordable home, only for the sales agents to tell them: "This is an all-white community." Civil rights organizations challenged the racist exclusions, but the Levitts

and their federal underwriters refused to budge. The postwar era was a time, in the words of historian Arnold Hirsch, when federal officials repeatedly "chose segregation."[22]

But in focusing so much attention on the exclusions keeping people out of new suburbs, historians have overlooked the utter chaos in places—like Levittown—where the contradictions of postwar liberalism created an incomprehensible tangle of public and private interests. As they piled subdivisions atop potato fields, Levitt & Sons prioritized short-term profits over long-term infrastructure. The company installed individual cesspools rather than sewers, left trash removal to private contractors, and made no plans for a library, a firehouse, or a hospital. Public education, a constitutional obligation of local governments, proved the largest oversight. In full-page newspaper advertisements, the company trumpeted "brand new schools" as one of the amenities included for "$58 a month." The assurance of "no extra charges for anything!" suggested the schools were already built. Upon arriving, however, people learned they would have to build the "new schools" themselves. As the district's enrollment ballooned, from 38 pupils in 1947 to over 12,000 in 1953, classes met in church basements, partitioned auditoriums, and the living rooms of model Cape Cods. Instead cooperating to deliver suburban prosperity, the partners in associational governance pushed fiscal responsibility downwards. The federal government insured the mortgages, a private corporation built the houses, and local governments were left responsible for the public services that had been promised in the advertisements.[23]

The dearth of school facilities was just as severe in other Nassau County districts. In Plainview, all 173 students shared one building: a rickety two-room schoolhouse built in 1898. In Massapequa, officials divided students into "double sessions," with half attending in the morning and half in the afternoon; even with the staggered schedule, classes still overflowed into a former convent, a rectory, and a firehouse attic. In Wantagh, by the time the district unveiled a new 500-pupil elementary school, its enrollment had swelled to 1,500, requiring a triple-shift schedule on opening day. By 1953, Frederick Tilney, a school finance consultant, saw no end to the crisis: "With some 10,000 houses going up every year, we can expect an increase of 13,000 new kiddies annually."[24]

---

[22] Biondi, *To Stand and Fight*, 229-233; Sugrue, *Sweet Land of Liberty*, 200-250; Hirsch, "Choosing Segregation."
[23] Redfield, "Impact of Levittown on Local Government"; Patterson, *Grand Expectations,* 70-75; Levitt & Sons, "$58!" advertisement, *New York Times*, Nov. 20, 1949, p. R3; Union Free School District 5 Minutes, Levittown Public Library, Eleanor K. Brownell, "Report to the Board at Regular Meeting," Aug. 27, 1952, reel 1.
[24] "173 Enrolled in 1898 School Built for 20," *Newsday*, Feb. 9, 1951, p. 7; Lewis A. Wilson, New York State Education Department Commissioner Subject Files, NYSA, Alfred G. Berner to James A. Webb, Oct. 19, 1951; Florence Virrick to Lewis E. Wilson, Oct. 27, 1951, both from folder 2, box 30; Val Duncan, "LI Schools Face Teacher Shortage, Overcrowding," *Newsday,* Sep. 3, 1953, p. 44.

All the "new kiddies" needed new classrooms, but with little state aid and no federal aid available for school construction, suburban districts were forced to rely almost entirely on the municipal bond market. As the New York State Board of Regents declared in 1950, "The problem of financing new school construction should be regarded as a local problem" with funds drawn "from local resources." As in most other states, New York districts borrowed by issuing general obligation bonds, which pledged all of their taxable property as collateral. Before issuing the bond, state law required officials to obtain taxpayer authorization in a popular referendum. Voters consented to property taxes that would repay the loan, plus interest, over an extended period, usually thirty years. Borrowing to build, voters mortgaged their future to pay for new schools in the present. But there was a hitch in the process. After voter approval, officials had two years to advertise the issue to investors, creating a window to float the bond when market conditions were most favorable. Voters thus had no idea what the final interest rate would be when they approved the loan. That came years later, sealed in envelopes.[25]

Just as school officials turned to the bond market, the swelling demand for credit pushed interest rates upwards. In the decade after World War II, the total amount of state and local bonded debt tripled, from $15.7 billion in 1945 to $45.8 billion in 1955. These bonds financed the infrastructural foundation of modern America: roads and bridges, sewers and waterworks, parks and public housing. Education, however, accounted for the largest portion; by 1955, fully one-quarter of municipal bonds were for school construction. Within the midcentury context of all-time-high income taxes, municipal bonds were effectively tax havens: safe places for investors to park their wealth and collect tax-free interest payments. But as the total volume of bonds spiked, the supply of tax-free securities exceeded the tax sheltering demands of wealthy investors, forcing municipal borrowers to pay higher rates to entice investors in lower tax brackets. School districts had to "compete in the open market for available funds," Arthur Levitt explained in a speech to Long Island school officials, and "increased interest rates [were] the result." In 1945, the average interest rate for a high-grade municipal bond was just 1.67 percent; by 1955, it had climbed to 2.53 percent.[26]

In the context of rising interest rates, the rate an individual district paid depended on how investors evaluated its creditworthiness. Private rating agencies made risk assessments of borrowing districts, appraising everything from aggregate wealth to debt burdens, enrollment

---

[25] New York State Commission on School Buildings, *School Building Problem in New York State*, 6-7; New York State Commission on School Buildings, *More Schools for Your Money,* 22-47; Sbragia, "Borrowing to Build."

[26] United States Department of Commerce, Bureau of the Census, *Historical Statistics of the United States,* 985, 1003; Robinson, *Postwar Market for State and Local Government Securities*, 43; New York State Assistant Secretary to the Governor Subject Files, NYSA (hereafter: Asst. Sec. Gov. files), Arthur Levitt, "Problems of School Financing," speech, Dec. 6, 1956, 3, "Education—School Marketing Bonds," folder, box 7.

levels to repayment history. This risk assessment process is best understood in comparative perspective. Two Nassau County districts, Levittown and Great Neck, floated bonds a day apart in May 1949, facing nearly identical market conditions. Moody's Investor Services gave the bonds for Great Neck, one of the wealthiest in the state, an A rating since it was a "well developed…upper middle class community" with "no pressing problems." Meanwhile, Moody's rated Levittown, "an unseasoned residential area" that had "grown by leaps and bounds in the last few years," one notch lower at Baa. In the eyes of investors, Levittown was riskier than Great Neck. As a result, Great Neck received a bid of 2.3 percent interest for its $2.47 million bond, and Levittown a bid of 2.7 percent for its $1.17 million bond. While the difference might seem negligible, these inequalities would compound over time. Districts that received higher rates paid more in debt service; the higher repayment costs diminished their creditworthiness, leading to even higher rates in future issues. Much as mortgage appraisers assigned letter grades to residential neighborhoods, marking areas as safe for investment based on their racial and ethnic composition, bond raters sorted municipalities into a wealth-based hierarchy. In both cases, risk assessments punished residents in places deemed uncreditworthy.[27]

Districts experienced rising interest rates as a local problem, but state officials sought to shield poorer districts from higher borrowing costs with aid payments, shifting some of the responsibility to the comptroller's desk. Indeed, state governments—which political scientist Martha Derthrick calls the essential "middle tier" in American federalism—stepped in to manage the conflict between expansive federal policies and the limited capacity of local governments. In 1950, the New York legislature established "Emergency School Building Aid." Designed as a temporary measure, lawmakers renewed the program on a year-to-year basis before making it permanent in 1956. Under this program, the state reimbursed districts for any interest costs in excess of a baseline tax levy. The state grants effectively placed a ceiling on the amount of debt service each district paid, shifting much of the debt burden to the state. "The main loser on higher interest rates is not the local taxpayer," concluded a group of consultants surveying Levittown, "but the State itself." This makeshift arrangement created a direct incentive for the comptroller, as chief fiscal officer, to devise solutions to the problem of rising interest rates in rapidly growing suburban districts.[28]

---

[27] Government Statistical Corporation, *School Districts of Nassau County*, 13; *Moody's Bond Survey* 41, no. 20 (May 16, 1949), 470-71; Yinger, "Municipal Bond Ratings and Citizens' Rights." On a similar dynamic of compounding inequalities resulting from tax preferences, see Ott, "Tax Preference As White Privilege."

[28] Muriel and Julian Kane Collection, Stony Brook University Special Collections and University Archives (hereafter: Kane files), Government Statistical Corporation, *The History of Financing Education in the Levittown School District, 1947-48 to 1958-59* (1959), 6-7, folder 5, box 4; Temporary Commission on Educational Finances, *Final Report*, 166, 184-186; Derthrick, *Keeping the Compound Republic*, 43-55.

School Finance from the Comptroller's Desk

The strain of rising interest rates was a common experience across the country. Following the Fed-Treasury Accord in 1951, the Federal Reserve raised interest rates to slow inflation, undermining the expectations for cheap credit. Rising rates forced policymakers to grapple with the competing promises of postwar liberalism. On the local level, the rise exacerbated inequalities between "well developed" communities like Great Neck and "unseasoned" ones like Levittown. It fell to state officials to manage the competing demands. The comptroller's desk sat at the intersection of these vectors, and despite the growing strain, fiscal mutualism remained the active framework for official market action. As the school construction crisis mounted, using pension funds to subsidize local borrowing costs still made sense politically.

New York's patchwork school aid formula, which obliged the state to absorb the interest costs, encouraged Levitt's predecessor, Comptroller J. Raymond McGovern, to invest in local school bonds. Due to "vast increases in school populations in suburban areas," McGovern noted in 1954, the volume of school issues "was greater than the normal market would absorb." To "establish an orderly school bond market," McGovern began directly bidding on school bonds. Unlike the traditional practice of retail buying, where the comptroller shaped markets by purchasing school securities from bond dealers, in direct bidding the comptroller could set the price by placing a state envelope on top of the pile. The first direct purchase was, fittingly, for Levittown. In the summer of 1953, a "market break" drove up interest rates just as the district floated a $3.2 million bond. McGovern told the investment bankers that he intended to bid on the issue at 3.3 percent interest. Given the prevailing market conditions and Levittown's shaky credit profile, the syndicates demurred, claiming they could not resell the bonds profitably at that price. With no other bids, McGovern's was the only envelope on the table.[29]

The Levittown deal was the first of many direct bids by the comptroller. A few weeks later, NYSERS won a $3.28 million school issue from an upstate rural district by offering 3.4 percent interest, underbidding the second-lowest offer of 3.7 percent from a banking syndicate. Over the next year, McGovern directly bid on 228 school bond issues and won 34 of them. In doing so, McGovern enlarged the NYSERS holdings of school bonds from $9 million in 1953 to $44 million in 1954—an over fourfold expansion within a single year, which increased the pension's holdings of school bonds from 2 percent to 6 percent of the portfolio.[30]

---

[29] *Annual Report of the Comptroller* (1954), 15-16; "State Pension Fund Buys Hempstead School Bonds," *New York Times*, June 4, 1953, p. 48; "State Controller Wins School Issue," *New York Times*, Dec. 23, 1953, p. 36.
[30] "State Controller Buys More Bonds," *New York Times*, July 1, 1953, p. 44; Paul Heffernan, "Bond Issues Feed the School Plant," *New York Times,* Sep. 19, 1954, p. F1; *Annual Report of the Comptroller* (1954), 15-16.

McGovern never publicly discussed these purchases, but observers recognized that direct bidding required a tradeoff between investment returns and interest costs. "By underbidding the banking syndicates the Controller is investing the pension fund money of…public employes [sic] at returns less than the going market," the *New York Times* observed. "On the other hand," the paper continued, "the under-the-market bidding reduces building costs for fast-growing school districts and thereby reduces, too, the amount of emergency state aid which the Controller must remit to such districts." In the face of this apparent tension, McGovern remained committed to balancing the competing promises—of secure pensions for state workers and modern schools for suburbanites—through mutual investments. Still, it was a tenuous balance. If school bond prices rose too high, the comptroller would have to pay the excess interest costs with state construction aid. If prices fell too low, it meant lower returns for retirees, and the comptroller might then have to meet the pension's guarantee to workers with deficiency payments.[31]

In January 1955, McGovern handed this dual responsibility to Arthur Levitt, who had been elected comptroller the previous November. Nationally, the 1954 midterm elections returned Democrats to control of Congress and several state legislatures following Dwight Eisenhower's sweeping victory two years earlier. In New York, the election ushered in the administration of Democrat Averell Harriman and, further down the ticket, Arthur Levitt. A career lawyer, Levitt volunteered for military service during World War II, rising to the rank of colonel in the Judge Advocate General Corps. After the war, Levitt dedicated himself to public service and the New York Democratic Club. In 1952 he was appointed to the New York City School Board, the largest system in the nation, and in 1954 he was elected its president. Levitt built his campaign for comptroller on his education experience, calling for increased state support of local schooling. These appeals resonated in strained suburbs, and local papers were quick to notice a connection. "Although his name is the same," the *New York Times* reported, "the new candidate said he was not related to another Levitt family from Brooklyn—the one responsible for the construction of Levittown on Long Island."[32]

While Levitt advocated for increased state aid on the campaign trail, he remained vague on the specifics. As comptroller, he continued purchasing school bonds with pension funds. But he did so to cultivate, rather than dominate, school bond markets. Unlike McGovern, who bid directly on school issues, Levitt made informal commitments to purchase the securities that investment bankers could not sell in secondary markets. In March 1955, mere months into his tenure, one Long Island district prepared an enormous $15.5 million issue, the largest school

---

[31] "State Controller Wins School Issue," 36.
[32] David Beetle, "Comptroller-Elect Cited Many Times for School Board Work," *Ithaca Journal*, Dec. 9, 1954, p. 10; "Levitt Proposes More School Aid," *New York Times*, Oct. 1, 1954, p. 14.

bond ever floated in the state. The local school board urged Levitt to bid directly to prevent an exorbitant interest rate. Levitt declined the request, which would have consumed 2 percent of the entire NYSERS portfolio. Instead, he held private discussions with the investment bankers organizing a bid for the issue. In advance of the offering, Levitt agreed to purchase $3 million of the longest-dated, least-desirable securities with pension funds, which helped hold down the final price. A syndicate of thirty-one investment banks purchased the issue for 3.1 percent interest, an outcome that reportedly made the school officials "very happy."[33]

Backroom conferences secured the deal, but the episode revealed that the comptroller would no longer attempt to make direct purchases. "I avoided fixing the price," Levitt told *The Bond Buyer*. "Instead of freezing entire issues in the retirement system's portfolio," he explained, "I accomplished the objective of maintaining a market without placing myself in the position of open competition with the investment fraternity." The comptroller might still purchase school bonds, and in this way adhere to the political obligations of fiscal mutualism, but school boards could no longer expect an envelope from the state. Levitt's pivot also reflected practical necessity. Even with a portfolio nearing $1 billion, he could not finance the entire school boom on his own. He needed the investment fraternity at the table. Nevertheless, Levitt remained committed to supporting school construction with the pension funds. Through indirect purchases, Levitt acquired an additional $110 million worth of school bonds during his first two years as comptroller, expanding school bond holdings to 8 percent of the NYSERS portfolio by 1956.[34]

The escalating interest costs, however, became an unavoidable problem. With the economy booming, Federal Reserve officials continued to battle inflation by tightening monetary policy, raising the central bank's discount rate in April 1956, and then again in August. Fed officials pushed interest rates to their highest levels since the 1930s, threatening the public priorities that relied on private capital. This policy of "Tight Money," as critics called it, sparked intense political debate, especially among Democrats seeking an election year issue.[35]

Tight Money shocked the school finance system, driving up the price of borrowing at the height of the construction boom. School bond interest rates soared in 1956, from a statewide average of 2.91 percent in May to 4.08 percent in November. The massive Levittown issue that year punctuated the upsurge. At the sky-high rate of 4.30 percent, it revealed the inadequacy of previous attempts to control interest costs. And it was not an outlier. In the six months

---

[33] "Levitt Letter 'Censored': NHP Civics," *Newsday*, April 19, 1955, p. 25; "Record School Bonds Sold By District; Board 'Happy,'" *Newsday*, March 4, 1955, p. 32.
[34] "Regional Marketing of N.Y. School District Bonds Under Study," *The Bond Buyer*, Jan. 12, 1957, p. 4; *Annual Report of the Comptroller* (1956), 15.
[35] *Conflicting Official Views on Monetary Policy: April 1956*, 84 Cong. (1956).

surrounding the Levittown deal, sixty-six districts sold a total of $96 million in school bonds, many of them with interest rates over 4 percent. Working within the bond markets, the comptroller could subsidize school construction one envelope or one backroom deal at a time, but he could not halt the secular rise in interest rates. Doing so would require either changing federal monetary policy or reforming the structure of school finance.[36]

Levitt became an outspoken opponent of Tight Money, laying out his critiques before Congress's Joint Economic Committee, which convened in 1956 to interrogate Federal Reserve Chairman William McChesney Martin about monetary policy. In Levitt's view, the Fed's credit adjustments favored private over public borrowers. As interest rates shot up, Levitt implored, local governments bore the extra costs, endangering the promises of postwar liberalism. "The quality of education will suffer," he warned the committee. Pointing to the debacle in Levittown, he continued, "when [Levittown] has to pay $2 million more interest, it means that taxpayers…must dig out of their pockets $2 million more to pay the cost of the new school building." Whereas a business or a homebuyer might postpone their borrowing until interest rates dropped, school districts could not wait for more favorable terms. By the time school officials entered the bond market, construction was usually already underway. They did not have the option of holding out for more favorable market conditions.[37]

While a fierce critic of Tight Money, Levitt hedged on whether public pensions should be part of the solution. As interest rates kept rising, Levitt began to openly articulate the fundamental tension: that the interests of schools and pensioners were in conflict. Levitt promised that he remained "prepared to make emergency purchases" of school bonds, but he also said that "his duty as the sole trustee of the [retirement] fund made it incumbent on him to obtain the highest return possible." At a luncheon of the New York State Citizens Committee for the Public Schools, Levitt expanded on this position. The attendees urged Levitt to purchase more school bonds, to which he responded: "I…intervene directly in instances when no bids are anticipated, or when bids are properly rejected as grossly inadequate." Doing so, he explained, "accomplished the objective of maintaining a market" for school bonds. But he also tempered expectations, emphasizing his dual responsibility. "I am always mindful," he added, "of my obligation to the members of the Retirement System to make investments at the highest rates

[36] Asst. Sec. Gov. files, "Average Interest Rates on School District Bond Issues for Upstate New York and Nassau and Suffolk Counties," April 3, 1957, "Education—School Marketing Bonds" folder, box 7; "School Bond Sales, New York State, Oct. 1956-March 1957," in *Federal Aid to States for School Construction*, 85 Cong. 1189 (1957).
[37] "U.S. Credit Policy Held School Curb," *New York Times*, April 30, 1956, p. 1; *Monetary Policy: 1955-56*, 84 Cong. 24, 26 (1956) (Statement of Arthur Levitt, Comptroller of the State of New York).

afforded by the market."[38] For pension managers like Levitt, the new environment of postwar inflation called into question the prudence of municipal bond investments.

Public Employee Pensions and the Quasi-Public Welfare State

Levitt's call to secure "the highest rates afforded by the market" also reflected disagreement among state policymakers over the purpose of public pensions. Across the country, state fiscal officers chafed under investment restrictions crafted to encourage fiscal mutualism. Then, in 1954, Congress extended Social Security coverage to state and local government employees, which forced a reckoning with the "publicness" of state pension benefits in the context of federal social insurance. For Levitt, who had built his reputation as a champion of public education, retirement became a second calling, especially as policymakers grappled with how NYSERS should meet—or perhaps even expand—its promises to state workers and retirees. Before the large-scale expansion of public employee unionization in the 1960s, Democratic politicians like Levitt positioned themselves as the elected representatives of state workers. In deliberations about social security extension, Levitt and his colleagues reconfigured state obligations to employees, along with the financial means of meeting them.[39]

State employee pensions had always occupied an ambiguous position in the mixed public-private structure of retirement provision. By the 1950s, many believed New York's hybrid system, which sought to both reward loyal service and protect against disability, did not accomplish either. Eager to extend federal benefits to state workers, policymakers began drawing sharp distinctions between federal Social Security and state pensions. In a 1955 report, the State Commission on Pensions argued that Social Security emphasized "social adequacy" by protecting workers and their dependents from destitution. State pensions, by contrast, "deal with each member on an individual basis," providing benefits for service to an employer. Separating these functions represented a crucial ideological step, allowing policymakers to reconceptualize the purpose of the state retirement system. Levitt sold the proposal by emphasizing that extending Social Security would raise retirement income "in almost every

---

[38] Albert Kraus, "State Is Studying School Cost Cuts," *New York Times*, Oct. 27, 1956, p. 28; "Regional Marketing Of N.Y. School District Bonds Under Study," 4.

[39] For the place of public employee unions within state policy debates, compare late 1950s Governors Committee on the Vesting of Pensions and Governor's Committee on Investment of Public Pension Funds with late 1960s Governor's Commission on State Employee Retirement System. Levitt files, "Retirement – Vesting Committee" folder; "Kaplan Committee on Pension Funds" folder; "Governor's Comm. On State Empl. Retire. Syst. (Moore Com.) 1966-1968" folder, box 4.

instance." He thus shifted the rationale for pensions from adequacy to maximization, a strategy that implied maximizing returns on its investments.[40]

The reconceptualization of state pensions as akin to private retirement benefits made it easier to distance pensions from the obligations of fiscal mutualism. As such, the goal of raising retirement benefits dovetailed with pension deregulation. Here, NYSERS was a relative latecomer. Many states already allowed their pension systems to invest some of their assets in private securities, usually conforming to the legal lists authorized for state-regulated financial institutions, such as insurance companies or savings banks. Where allowed, pension trustees diversified into private securities during World War II, when rising federal tax rates widened the yield gap between taxable and non-taxable bonds. Other states responded to low municipal yields by deregulating pension investment powers in the early 1950s. New Jersey authorized corporate bond purchases "to obtain investments with a higher rate of return," while Pennsylvania did so "to meet the state's guarantee of 4 [percent] interest on pension funds." New York City followed the same path, in 1953 authorizing the city comptroller to invest in corporate bonds. As public pension managers shifted into corporate assets, they followed the lead of private pensions, which faced fewer regulatory restrictions or pretentions of public service. By the early 1950s, private pensions held virtually no municipal securities and were transitioning their holdings from corporate bonds to common stocks. Public and private pensions were undergoing, as one commentator observed in 1953, "something like a revolution."[41]

To spark this revolution in New York, Levitt began lobbying for statutory changes that would broaden his investment powers. At his urging, New York lawmakers introduced a bill in 1956 to liberalize NYSERS's investment authority, allowing the fund to invest 15 percent of its assets in the bonds of highly-rated corporations, like railroads and utility companies, which offered higher yields than municipal bonds. The New York City employee pension and the state teachers' pension—both institutionally separate from NYSERS—already had limited power to invest in certain corporate securities, and the legislature readily adopted the bill. However,

[40] Hacker, *Divided Welfare State,* 126-129, 138; State of New York Commission on Pensions, *Report of the State Commission on Pensions*, 17; "Controller Urges Combined Pensions," *New York Times*, May 16, 1956, p. 37.
[41] Andrews, "Retirement Funds in the Financial Structure," 404-408, 414; "Pennsylvania Invests Pension Funds in Corporate Bonds," *Wall Street Journal*, Jan. 20, 1954, p. 13; "Investments Lift Jersey Funds' Value by $88,000,000 in Year," *New York Herald Tribune,* March 11, 1952, p. 28; Paul Crowell, "City Pension Fund Gets Wider Power," *New York Times*, May 17, 1954, p. 16; Stevenson, "Why the Prudent Man," 74. For a contemporary examination of private pension plans, see Committee on Labor and Public Welfare, *Welfare and Pension Plans Investigation*, S. Rep. No. 84-1734 (1956).

Governor Harriman vetoed it. Since the constitution prohibited the state from making loans to private corporations, Harriman worried that the deregulatory law might be unconstitutional.[42]

Levitt was more successful in extending Social Security to state employees. After months of internal debate, the Harriman administration put forward Levitt's bill in November 1956, which extended social security coverage to state and local government workers. In April 1957, the legislature adopted the plan. With Social Security providing a new benefits floor for state workers, Levitt could seek greater rewards for pensioners. His advocacy, then, for "the highest rates afforded by the market," reflected at once the failure of pension liberalization and the success of Social Security extension. It also embraced a growing consensus among state fiscal officers—and the investment bankers who increasingly advised them—that fiscal mutualism no longer offered a viable rubric for pension investment. As Wisconsin's Investment Commissioner explained to a group of state officials at a 1957 conference, "one group suffers at the expense of the other, and my personal inclination is toward the belief that the pension funds do most of the suffering." Levitt, a keen observer of these debates, was inclined to agree.[43]

The School Financing Authority

Even as Levitt pursued higher returns, he grasped for a durable solution to the school construction crisis. After the Levittown debacle in November 1956, Governor Harriman appointed a committee of state policymakers and financial executives to study the problem of rising interest rates, naming Levitt its chairman. Ostensibly, the Committee on the Marketing of School Bonds was tasked with developing policy proposals by drawing on the experiences of other states, especially places like California and Pennsylvania that financed school construction with state-backed bonds. Economies of scale, Harriman noted, "appear to be beneficial." As the Committee examined alternatives, however, its deliberations became a forum for assessing the merits of fiscal mutualism.[44]

In January 1957, the committee put forward a plan to restructure the school bond market in New York. The committee proposed a new "State School Financing Authority," which would purchase the issues of individual districts, bundle them, and then market them together

---

[42] "Bill Would Ease Finds' Investing," *New York Times*, Feb. 11, 1956, p. 32; Paul Heffernan, "Huge Funds Tap at Market Door," *New York Times*, April 1, 1956, p. 131; Paul Heffernan, "Pension Investing Raises Questions On Status of Funds," *New York Times*, May 20, 1956, p. 171.

[43] "Social Security Bill Covers State Aides," *New York Times*, Nov. 29, 1956, p. 19; J. E. McMahon, "Pension Law Aids Public Employees," *New York Times*, April 23, 1957, p. 24; Charles Jacobson, "State Laws Governing the Investment of State Pension Funds," *Report of the Forty-Second Annual Convention of the National Association of State Auditors, Comptrollers, and Treasurers* (Sept. 1957), 102.

[44] "Ave Moves to Cut Cost of New Schools," *Newsday*, Nov. 28, 1956, p. 7; James E. Allen, New York State Education Department Commissioner Subject Files, NYSA (hereafter Allen files), John K. Weiss to Governor's Committee on Marketing School Bonds, Memo: "Report of Progress as of January 4, 1957," 10-14, folder 10, box 48.

in several large offerings each year. The committee predicted that these economies of scale would make the Authority bonds appear less risky to investors. In this way, explained bond dealer Cushman McGee, "The market can be widened." The plan proposed a fundamental change in the state's relationship to bond markets. Under fiscal mutualism, the state used its buying power to shape market demand by purchasing bonds; with the School Financing Authority, it would instead use its selling power to shape market supply by selling bonds in bulk. Under the proposed arrangement, Levitt estimated that the Authority would pay interest rates one whole percentage point lower than the current average. With some back-of-the-napkin math, he predicted $15 million in interest savings over five years, including $10 million in Long Island alone.[45]

Not everyone agreed with the committee's projections. In a memo to high-ranking state officials, the Investment Bankers of America argued that the Authority would, in effect, create a pool of high-risk bonds. Since wealthy districts could obtain lower rates on their own, they had no incentive to sell to the Authority. Only the least-creditworthy districts would utilize it, and a portfolio of bonds from the poorest districts would negate any savings. Commercial bankers also objected, though for different reasons. Federal regulations prohibited commercial banks from purchasing the obligations of public authorities. At the time, commercial banks were the fastest-growing market for municipal bonds and shifting school bonds to a public authority would cut them out. With fewer potential investors, a group of legislators concluded, "it is not improbable that the net result of the [Authority] would be to *increase* the overall cost of school financing." Swayed by these objections, lawmakers never allowed for a hearing, let alone a chamber-wide vote. "School Bond Plan Dies in Committee," read the headlines.[46]

Although the committee never addressed fiscal mutualism publicly, behind closed doors the pension purchases of school bonds were the subject of intense deliberation. Of all the topics discussed, the anonymized meeting minutes emphasized, "convictions run more strongly on this particular subject than almost any other." For their part, advocates of fiscal mutualism argued that pension funds "must be invested somewhere and that the public interest is best served by investing them in obligations of New York State and its local jurisdictions." For the opponents, however, it was "amoral" for the comptroller to "underbid the market" since he "depriv[ed] the

[45] Governor's Committee on the Marketing of School Bond, *Schools for New York*, 13-20; Allen files, Cushman McGee, Memo: "State Authority Plan," Jan. 25, 1957, folder 10, box 47; Asst. Sec. Gov. files, "Estimated Cost of Construction, 1957-1959, By County," "Education—School Marketing Bonds" folder, box 7.

[46] Allen files, Municipal Securities Committee, New York Group, Investment Bankers of America, "Memo re: Committee on the Marketing of School Bonds," March 20, 1957, 12-13, folder 10, box 48; Memo: "New York State School Financing Authority" [emphasis added], March 30, 1957, 7-8, 10, folder 10, box 47; "Banking Opposition Perils School Bond Plan," *Newsday*, March 19, 1957, p. 7; "School Bond Plan Dies in Committee," *Newsday,* March 30, 1957, p. 1.

State employees of their rightful return on their retirement funds." The meetings underscored the comptroller's dilemma. As local officials and state retirees both made claims on NYSERS's funds, the question could no longer be avoided: Whose interest, the schools or the retirees, was the public interest?[47]

For the time being, Levitt maintained an unsteady middle course. With the School Bond Authority scuttled and interest rates still climbing, he continued purchasing school bonds, investing an additional $40 million over the next two years. By 1958, school issues comprised fully 11 percent of NYSERS's portfolio. But these purchases, Levitt emphasized at a conference of the Municipal Finance Association of America, were merely an "expedient." While the indirect purchases helped "encourage the submission of bids" from banking syndicates "on issues that would otherwise have gone unsold," he still refrained from bidding directly. "As sole trustee of the Retirement System," he avowed, "I am duty bound to seek the highest return the market affords."[48] Given the persistent yield gap between municipal and private securities, the prevailing ideology now dictated that it was the "fiduciary duty" of trustees to seek the highest investment returns available in the marketplace.

Despite the wavering rhetoric, therefore, Levitt pursued fiscal mutualism up until the 1958 election. This decision reflected both a pragmatic response to the school construction crisis and calculated support for the Harriman administration. Even as Levitt attempted to extricate himself from his conflicting obligations, he made lower school interest costs and higher pension benefits twin pillars of his reelection bid. Many observers concluded that his thwarted campaign for the School Bond Authority proved decisive in his surviving the Republican wave that swept Governor Nelson Rockefeller and a slate of new legislators into office. Like all Democrats in 1958, Levitt lost heavily in the suburbs; he only managed to not lose as badly as Harriman.[49]

Fiduciary Finance and the Logic of Deregulation

Rockefeller's victory backed Levitt into a corner. He survived the election on the strength of his school bond proposal and, as the sole statewide Democratic official, stood poised to lead his party. Still, he needed a broader base of support, and for this he turned to pension deregulation. While the incoming Rockefeller administration sought fiscal support for gubernatorial projects, Levitt renewed his campaign to expand NYSERS's investment powers. In doing so, he shrouded a potent ideological transformation in the neutral rhetoric of nonpartisan expertise and fiduciary duty. "When you deal with money and investments, political

[47] Allen files, Weiss, "Report of Progress as of Jan. 4, 1957," Jan. 7, 1957, 13-14, folder 10, box 47.
[48] *Annual Report of the Comptroller* (1959), 15; Levitt, "Tight Money and Municipal Borrowing," 21.
[49] "Arthur Levitt's Victory," *Newsday*, Nov. 7, 1958, p. 41.

considerations play no part," he said in the days after the election. "It involves personal integrity, skill, devotion to duty. Not politics." He was posturing, of course. Fiduciary language fit the new political landscape. Under a Democratic governor, Levitt had embraced the political logic of fiscal mutualism, even as the economic logic became less tenable. Shorn of political constraints under Rockefeller, Levitt became the dour face of market discipline, and this disposition would lead him to the doorstep of Goldman Sachs.[50]

With Rockefeller in office, Levitt continued his campaign to liberalize NYSERS's investment powers. In 1959, the legislature adopted a Levitt-authored bill authorizing NYSERS to invest up to 20 percent of its assets in the bonds of corporations, railroads, and public utilities. Seeking Rockefeller's signature, Levitt emphasized the plan's fiscal advantages. The bill, Levitt argued, would "increase the income to the Retirement System," which "may well lead to the reduction of contributions…[by] the State, as well as an increase in the retirement benefits to our members." The Civil Service Employees Association, the state's main public employee union, endorsed the legislation, which aligned NYSERS's powers with those of other large pension systems. Eighteen states already allowed corporate investments, including Wisconsin, whose state pension held over half of its assets in corporate bonds, and one-fifth in corporate stocks. New York remained a follower in pension deregulation.[51]

The only direct opposition came from local school officials, who recognized that corporate securities would likely replace school bonds in the NYSERS portfolio. The New York State School Boards Association, in a missive to Governor Rockefeller, protested that the legislation "did not [offer] any relief for the high interest rates on school district bonds." Instead, they continued, "the bill…might have the effect of reducing the amount of retirement funds which the comptroller presently invests in school district bonds." As the school officials recognized, deregulation would remove the backstop of state investment.[52]

As the school officials anticipated, Levitt immediately began pursuing higher market returns. To do so, he assembled a new Investment Advisory Council. Comprised of leading financial executives, including Richard S. Perkins of First National City Bank and Charles S. Dickey of Morgan Guarantee Trust Company, Levitt assembled the group to provide "counsel…in the conduct of the System's investment programs." Goldman Sachs Senior Partner,

---

[50] Arthur Levitt Oral History Project, Hamilton University Special Collections, John Jay Feeney, "Reminiscences of John Jay Feeney," oral history transcript, 1984, p. 10; Stan Hinden, "On the Inside of Politics," *Newsday*, March 5, 1959, p. 7C; "3 Albany Bills Curb Democrats," *New York Times*, March 14, 1959, p. 15; Arnold Brophy, "A Newsday Profile: The Dems' Sole Survivor," *Newsday*¸ Nov. 11, 1958, p. 26.
[51] Warren Weaver, Jr., "Levitt Proposes Own List of Bills for Legislature," *New York Times*, Dec. 15, 1958, p. D1; John T. DeGraff to Roswell B. Perkins, 31 March 1959, at 5; Arthur Levitt to Nelson A. Rockefeller, 7 April 1959, at 14; NYSA, Arthur Levitt to Roswell B. Perkins, 9 April 1959, at 15, bill jacket, L. 1959, ch. 833.
[52] NYSA, Everett R. Dyer to Nelson Rockefeller, 13 April 1959, at 4, bill jacket, L. 1959, ch. 833.

Sidney J. Weinberg, who led the group, was perhaps the most influential financier in postwar America. Known as "Mr. Wall Street," Weinberg advised every president from Franklin Roosevelt to Lyndon Johnson.[53]

Levitt arrived at Goldman's downtown offices in May 1959 eager to offload low-yielding municipal bonds. The financiers, however, worked to manage his expectations. "Maximum yield should not be the determining factor at all times," the bankers told him. They impressed the importance of long-term diversification, emphasizing that the transition to higher-yielding assets would take time. "The diversification of a Fund of this size cannot as a practical matter be changed abruptly," the committee agreed. Disinvestment needed to be gradual and strategic. With the school crisis ongoing, the committee recommended maintaining ten percent of pension assets in school bonds. Given that school bonds still comprised 11 percent the portfolio, the financiers were not advising more purchases. They were simply urging that Levitt take his time orchestrating the sell-off.[54]

In addition to investment guidance, the Advisory Council furnished a shield against the Rockefeller administration's calls to maintain fiscal mutualism. Rockefeller entered office with vast infrastructural ambitions that required borrowed funds. When Rockefeller's advisors solicited favorable pension investments, Levitt replied that any loans from NYSERS would have to reflect current market conditions, a stance that his financial advisors encouraged. In early 1960, for example, Rockefeller requested below-market loans to finance the construction of new state office buildings. Levitt, citing his advisors, responded that "this method of financing" was no longer "advantageous to…the Retirement System." Rockefeller, just like the school districts, would have to pay the going price in the bond market.[55]

In state capitols across the nation, fiscal officers attempted to extricate themselves from the contradictions of fiscal mutualism. As state pensions continued to grow, governors and legislators coveted their investment funds, and pension managers found themselves torn between competing positions: as pension trustees *and* state managers. At the 1958 Convention of the National Association of State Auditors, Frank S. Szymanski, Michigan's state auditor, explained how the state's legislature wanted the pension to finance a new office building at below-market rates. "We have a conflict of interest," he explained. Other attendees reported

---

[53] Levitt files, Press Release, March 18, 1959, "Retirement—Retirement Adv. Comm." folder; Press Release, May 1, 1959, "Retirement—Investment Adv. Comm." folder, box 3; Alden Whitman, "Sidney J. Weinberg Dies at 77; 'Mr. Wall Street' of Finance," *New York Times*, July 24, 1969, p. 1.
[54] Levitt files, Minutes, Meeting of Comptroller's Investment Advisory Council, May 27, 1959, "Retirement—Investment Adv. Comm." folder, box 3.
[55] Levitt files, Minutes, Advisory Council Meeting, September 22, 1959 and May 6, 1960, "Retirement—Investment Adv. Comm." folder, box 3; Arthur Levitt to T. Norman Hurd, Oct. 11, 1960; T. M. Whalen to Arthur Levitt, Jan. 8, 1964, "Retirement– Constr. State Bldgs with Fund," folder, box 8.

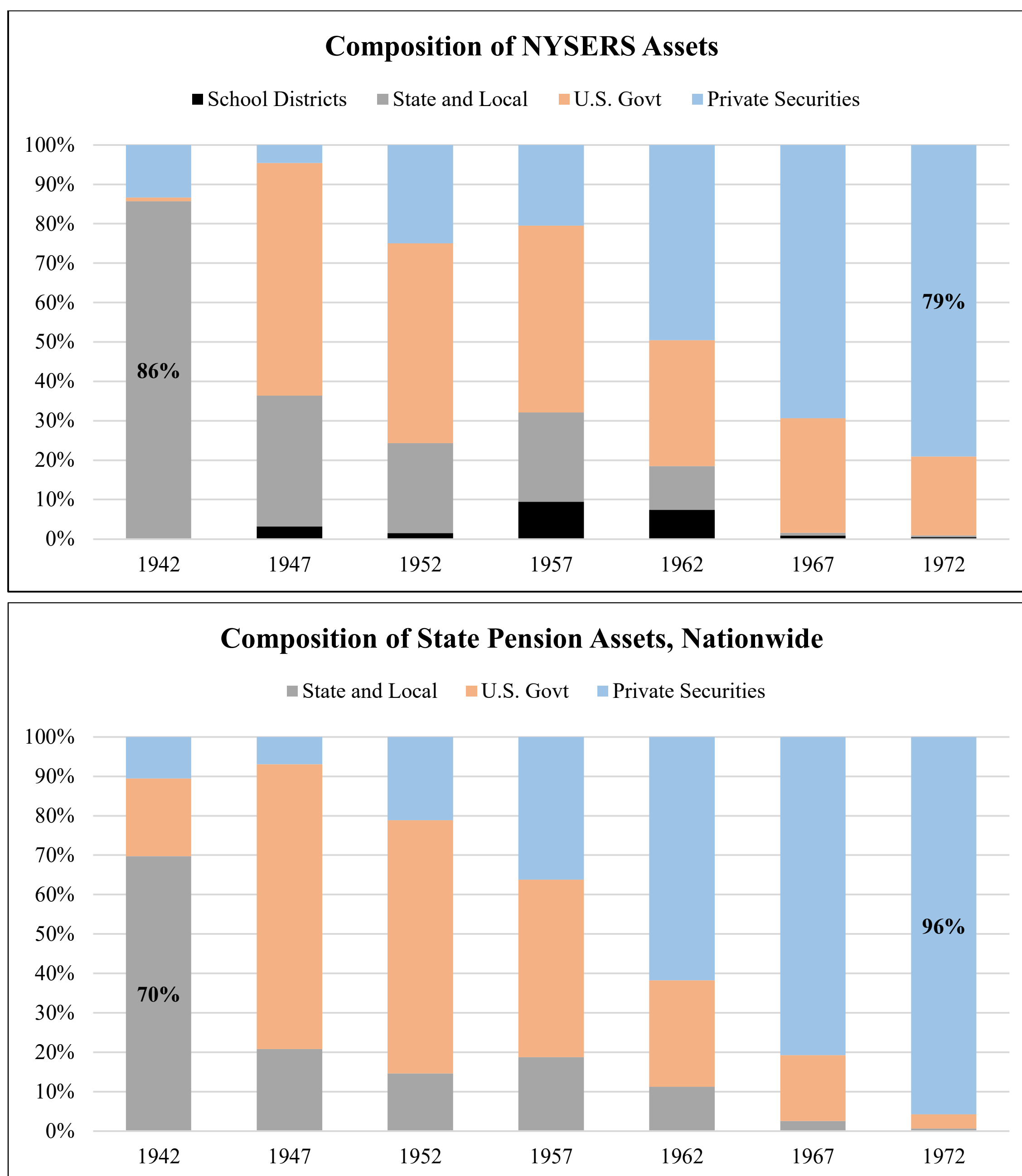
similar pressures. Although they expressed support for essential infrastructure projects like school construction, these considerations had ultimately been reduced, as one delegate put it, to "the question of yield." If the returns were in line with other potential investments, then such financing would be acceptable. Nonetheless, most state officers agreed that it would be best if governors and lawmakers stopped putting them in this position at all. "I think they would be better off," Szymanski concluded, "if they went into the open market."[56]

Following the lead of other states, Levitt sought further deregulation. In 1960, the legislature acquiesced, authorizing NYSERS to invest in commercial mortgages not insured by the FHA and to allocate up to 10 percent of its assets in common stocks. "The day when pension systems automatically filled their portfolio by the purchase of government securities and political subdivisions of the State is long past," Levitt wrote in support of the law. Instead, "modern techniques, modern precautions and modern safeguards can well permit the wise pension trustee to diversify considerably and safely to radically raise the income of a public pension system." Deregulation allowed fiduciary duty to supplant fiscal mutualism as the guiding principle of pension investment. New York, like other states, effectively decoupled state investment from local financing, removing the dilemmas of postwar liberalism from the comptroller's desk.[57]

With the 1960 legislation approved, Levitt began remaking the NYSERS portfolio. At their next meeting, the Investment Advisory Council prepared to rid the retirement system of municipal bonds. After reviewing the "sizeable" municipal bond holdings, the Council decided that "since the Retirement Fund does not benefit from tax exemption afforded by these bonds…their retention was not particularly appropriate." The comptroller should dispose of these securities, the Council advised, and "the proceeds of these sales be reinvested in higher yielding taxable bonds and mortgages." Though it would take time to fully disinvest the portfolio, the meeting effectively spelled the end of fiscal mutualism in New York.[58]

[56] Ottaviano, "Investment of Trust and Pension Funds," 163.
[57] NYSA, Letter from Department of Audit and Control, April 7, 1960, at 18; Letter from John T. DeGraff to Robert MacCrate, April 12, 1960, at 12, bill jacket, L. 1960, ch. 817.
[58] Levitt files, Minutes, Advisory Council Meeting, May 6, 1960, "Retirement—Investment Adv. Comm." folder, box 3.

Fig. 3. **Public Pension Diversification, New York and USA**



Source: *Annual Report of the Comptroller*; Andrews, "Noninsured Corporate and State and Local Government Retirement Funds in the Financial Structure," 529-531; Robert Tilove, *Public Employee Pension Funds*, 205.

The Permanent Tax Revolt

Just as Levitt began unwinding fiscal mutualism, suburban taxpayers reached their breaking point. In May 1959, the voters of thirty-four districts, including twelve on Long Island, rejected their annual school budgets, inciting panic among state officials. While the tally of

rejections amounted to only 3 percent of all budget votes statewide, it was still the largest number in the state's history. Levittown encapsulated the frustrations behind the rebellion. Between 1948 and 1959, Levittown taxpayers had authorized ten bond issues to finance eleven new schools, for a total bonded indebtedness of more than $18 million. Over that decade, the property tax rate had nearly tripled (in real terms) to cover the attendant costs. Even with the state aid for debt service, about fourteen cents of every tax dollar went to repaying bondholders—and not to current expenses, like teacher salaries, classroom supplies, or extracurricular activities. Despite the enormous debt load and the soaring tax rates, in 1959 every student in first through third grade still attended school in half-day shifts due to a chronic lack of classroom space. The new schools simply could not be built fast enough. Levittown residents had little control over the market fluctuations that added unexpected costs to school construction. They did, however, possess the power to vote "no" on the budget.[59]

[59] "12 LI School Districts Kill Budgets," *Newsday*, May 7, 1959, p. 3; New York State Education Department Division of Research, *School District Voting*, 13; Nassau County Comptroller's Office, *Five Year Cumulative Report*, 49, 52; New York University, *Levittown's Schools and the Future of the Community*, 264, 445; Kane files, District 5 Board of Education, "Fact Sheet on the Site Proposition to be Voted Upon May 6, 1958," folder 3, box 2.

Fig. 4. **Levittown school board election flier, May 1959**.
Source: Stony Brook University Special Collections and University Archives.

The school tax revolt is best understood as a grassroots revolt against the fiscal volatility of the liberal state. Despite their many attempts to control interest rates, state officials had failed to shield suburbanites from fluctuations in bond markets. Comptroller Levitt admitted as much. "This was not a vote against education," he told reporters as the rejections piled up. It was "a revolt over the rising costs of local government." A flyer circulated by a slate of school board candidates in Levittown captured the logic behind the protest votes. At the center, the flyer depicted an exasperated taxpayer with money flowing out of both pockets—one for local property taxes, the other for state income and sales taxes—to pay for the glamorous "New Schools" in the background. At the bottom, it asked, "Who *Really* Pays for the Schools?" Individual confusion, inscrutable market forces, no sign of public officials—the flyer expressed, in picture form, popular discontent with the unfunded mandates. Although the candidates put forward no alternatives for how the schools might be financed, they did offer weary taxpayers an outlet for their rage. A vote for them, and against the budget, would supposedly "Stop Wasteful Spending of *Your* Money!" As Salomon Brothers partner Sidney Homer recognized, reflecting on the turmoil of the 1950s, "a new school…costs taxpayers dearly, and they know it."[60]

In the wake of the revolt, state officials instituted several reforms to help districts cope with the still-climbing interest rates. In the immediate aftermath, Levitt announced a new "financial advisory service," which would help districts participate more shrewdly in bond markets. Local officials could now consult professional investment bankers when preparing bond prospectuses and planning the timing of their issues. Legislators also added another category of state aid to reimburse school districts for "excessively high interest costs." The legislation defined an "excessive" rate as the statewide average plus one-quarter of one percent; for any interest payments above this level, the state would reimburse the costs. While the reforms offered relief to struggling districts, they pegged compensatory payments to fluctuations in bond markets. Wherever interest rates moved, so moved the definition of "excessive."[61]

Together, the emergency construction aid, the excess interest payments, and the demise of the School Bond Authority amounted to a state surrender to the municipal bond market. The shift was subtle, though ultimately consequential. Under fiscal mutualism, the state held a direct stake in public infrastructure. Officials used state investments to shape the bond market.

---

[60] Frank Johnson, "Say Tax Revolt Shows Need for School Study," *Newsday*, May 8, 1959, p. 7; Kane files, Information and Education Committee, "VOTE, May 6th," flyer, folder 2, box 4; Homer, "Factors Determining Municipal Bond Yields," 276.

[61] "Levitt to Counsel Schools on Bonds," *New York Times,* May 14, 1959, p. 50; Subject Files Concerning State Financial Aid for Education, NYSA, Division of the Budget, Research and Fiscal Planning Unit, Memo: "Interest Costs on School District Bonds," April 15, 1966, 5, "State Aid—Local School Construction," folder, box 6.

Through economies of scale, the School Bond Authority had aimed to enhance the position of districts with weak credit ratings. The compensatory aid payments took a different approach. Rather than attempting to influence the bond market, officials responded to its fluctuations. Rather than capping interest rates, they absorbed the increases. The combined state aid programs basically promised districts that the state would insulate them from rising interest costs.

This fiscal volatility was not confined to the suburbs. In New York City, too, the collapse of fiscal mutualism incited panic. Following the deregulation of its investment powers in 1953, the city's employee pension shifted into private securities. In 1959, 78 percent of its assets were invested in New York City bonds; by 1965, the figure had plunged to 35 percent. This sell-off coincided with the spike in interest rates. During a bond sale in the spring of 1966, the lowest bid the city received was for the steep price of 4.2 percent interest. Writing to the city comptroller, State Assemblyman Bertram Podell requested that the city pension reinvest in city bonds, so as to "give the Banking Monopoly second thoughts as to how far they can milk the people of our City." Podell implored, "I believe trustees of union pension funds would also find such City bonds attractive investments." The city comptroller replied with a curt message: "municipal tax-exempt [bonds] of no value to these funds!!" Podell pled for a revival of fiscal mutualism, but fiduciary duty dictated otherwise.[62]

The Promise of Financial Liberalism

Abandoning fiscal mutualism reconfigured the relationships between school districts, the state government, and bond markets. With investment returns soaring, state officials reimagined the benefits that pensions could offer to employees. Levitt continued to pursue, as he put it in his 1960 *Annual Report*, "maximum yield for the Fund," selling off municipal bonds and reinvesting the assets in private mortgages and corporate securities. In doing so, Levitt began campaigning to make NYSERS a completely non-contributory plan. Instead of workers and government employers paying equally into the retirement fund, state and local governments would pick up the entire tab. Higher investment returns created even grander expectations, expanding the public promises of postwar liberalism through the power of private capital markets.[63]

---

[62] *State and Local Public Facility Needs and Financing* 89 Cong. 404 (1966); Bertram L. Podell papers, M.E. Grenander Department of Special Collections and Archives, University at Albany, Bertram L. Podell to Mario Procaccino, May 2, 1966, Folder 23, box 1.
[63] *Annual Report of the Comptroller* (1960), 38.

The search for higher returns quickly became self-reinforcing. As Levitt offloaded municipal bonds for private securities, NYSERS aggregate yields rose, from 3.35 percent in 1959 to 4.33 percent in 1965. By 1962, the state no longer had to make deficiency payments. Many observers attributed this to deregulation. "Albany has been able to catch up on the pension problem," the *New York Times* reported, "because of the steps taken…to liberalize the investment powers of the state retirement system." Higher returns encouraged further deregulation. In 1964, the legislature increased the legal limit for corporate bond investments from 20 percent to 40 percent of the total assets. "Higher investment yields…have eliminated the necessity for additional employer contributions," Levitt argued in support of the legislation. "It is important," he impressed, "that the present overall investment yield…be assured of continuance insofar as it is possible."[64]

Even while discarding fiscal mutualism, Levitt hinted that the pension system might still intervene in bond markets. "We don't intend to get rid of all our municipals," Levitt told the *Wall Street Journal* in 1962. Despite the reservations, the sell-off proceeded at a brisk pace. In 1958, NYSERS held more than $350 million in municipal securities; by 1966, it held just $40 million, all in the high-risk school bonds that Levitt had purchased to buttress the market over the previous decade. In the short run, intervention proved unnecessary. During the 1960s, commercial banks surpassed wealthy individuals as the largest buyer of municipal bonds, with many of the bankers represented on Levitt's Investment Advisory Council bidding on the pension's bond sales. While interest rates never returned to their postwar lows, this influx of capital steadied the bond market during the 1960s. Because of their tax advantages, Salomon's Sidney Homer explained in 1966, "municipals were and are a veritable bonanza for all investor groups in the corporate [tax] bracket or higher." Municipal bonds were only "bonanzas" for investors subject to high income taxes, not for tax-exempt public pensions.[65]

With NYSERS yields steadily rising, Levitt began arguing that the retirement system could operate without any cost to workers whatsoever. In 1960, Levitt told a group of public employees that "a pension system entirely paid for by the employer" was an achievable goal. This was a utopian vision, one imagined through markets. After Levitt won reelection in 1962,

---

[64] *Annual Report of the Comptroller* (1965), 29; "Municipal, School Bonds Awarded by New York State Pension Unit," *Wall Street Journal*, May 7, 1962, p. 17; "Issues Are Placed by Pension System," *New York Times*, Nov. 22, 1962, p. 61; "New York Employees Fund Sells $16,754,000 Of Outstanding Bonds," *Wall Street Journal*, Nov. 23, 1962, p. 15; Paul Heffernan, "Financing Gains on Pension Funds," *New York Times*, Feb. 11, 1962, p. 133; NYSA, Arthur Levitt to Sol Neil Corbin, 19 March 1964, at 14, bill jacket, L. 1964, ch. 369.

[65] "New York Employees Fund Sells $16,754,000 Of Outstanding Bonds," 15; "New York Pension System Sells $24,982,000 of Bonds," *Wall Street Journal*, Dec. 12, 1963, p. 24; Martin Arnold, "Battle Waged in Albany to Control Pension Funds," *New York Times*, March 14, 1966, p. 1; Crowder and Wohar, "Changing Long-Run Linkage between Yields," 107; Homer, "Factors Determining Municipal Bond Yields," 271, 274.

his advisors urged him to make the non-contributory pension his "No. 1 proposal." Although the policy took time to enact and implement, by 1966 NYSERS had become a fully non-contributory system. No longer would state workers need to fund their retirement. Instead, financial markets would guarantee their future economic security.[66]

As Levitt reconstituted the NYSERS portfolio, state workers ratified the deregulatory agenda. "This is a knotty subject," one civil service employee wrote Levitt in the spring of 1965, since "the average person has a mystical fear of 'stocks,' 'investment,' and 'speculation.'" Nonetheless, after learning about the shift into private securities, many employees grew impatient at the gradual pace of change. Despite the 1960 legislation permitting NYSERS to invest up to 10 percent of its assets in common stocks, by 1965 stocks still accounted for only 3.5 percent of the portfolio. Included with the letter was a petition, titled "To Mr. Arthur Levitt," and it carried hundreds of signatures. "We, the undersigned participants in the New York State Employee Retirement System," the petition declared, "strongly urge the investment of at least ten percent of our contributions in common stocks." This shift in assets, the employees predicted, "will result in considerably enlarging our retirement benefits."[67]

Conclusion

When NYSERS was established in 1920, political conflict centered on employee contributions. Would retirement be financed from the take-home pay of workers or directly from the state budget? The investment function was taken for granted. Through legally prescribed investment powers, the state channeled pension funds into municipal bonds. Balancing the interests of state retirees and governmental borrowers, comptrollers subsidized public infrastructure. Fiscal mutualism, in sum, satisfied a range of constituencies while prioritizing stable investment over maximum returns. With the mutualist regulations stripped away, pension conflict shifted from who should make contributions to who should reap the gains of riskier investments. The expansion of public sector unions and new collective bargaining rules only increased the incentives for employers to resolve present disputes by making promises about the future. With the reconstitution of NYSERS as a contribution-free system, officials and pensioners depended on markets to deliver on those promises. Indeed, workers came to demand it.

---

[66] "Pension Gain Sought," *New York Times*, Sep. 2, 1960, p. 6; Levitt files, I. S. Hungerford to Advisory Council, Nov. 28, 1960, "Retirement—Retirement Adv. Comm." folder, box 3; Leon Braun to Arthur Levitt, Dec. 4, 1962, "Braun, Leon," folder, box 1; "Battle Waged in Albany to Control Pension Funds," 1.

[67] Levitt files, Paul Payne to Arthur Levitt, March 27, 1965; "To Mr. Arthur Levitt," petition, [n.d.], box 2.

The demise of fiscal mutualism produced divergent outcomes for public pensions and public schools. After a period of lower interest rates in the early 1960s, school bond rates shot up even higher, from a nationwide average of 3.67 percent in 1965 to 6.39 percent in 1969. The state, however, was no longer an active player in bond markets; the districts had to pay the going interest rate. State officials felt powerless. "[T]here is not very much we can do to lower interest costs," a Rockefeller aide complained in a 1969 memo. To help districts meet these costs—as well as rising salaries and operating expenses—lawmakers increased state school aid, which by 1970 accounted for over one-third of the state budget. But the state's support of local schooling did not extinguish the tax revolts. Instead, it escalated them, as overstretched taxpayers directed their rage at Albany lawmakers. In what became an annual plea for greater state aid, about one-fifth of school districts rejected their budgets every spring through the 1970s. "The problems encountered today in attempting to finance an educational system…are not new," Levitt sighed in 1971, "but they are growing more complex each year."[68]

Levitt's exasperation at the education system's market dependence contrasts sharply with his enthusiasm for NYSERs position as a powerful market actor. For example, in order to circumvent stock brokers and their high trading fees, Levitt sought a seat on the New York Stock Exchange in 1971. Although unsuccessful, the move helped precipitate the deregulation of brokerage commissions, part of the gradual reordering of the financial system by large institutional investors. Across the country, pension managers employed similarly aggressive tactics, seeking to maximize returns by broadening their investment strategies. This was part of a larger ideological project aimed at reimagining the social contract with capital at its center. For pension trustees like Levitt, "shareholder value" became their primary responsibility. Despite the immense power of large pensions like NYSERS, the retirement security of individual pensioners now depended on unpredictable financial currents. As went the stock market, so went their retirement portfolios. Ultimately, deregulation has largely delivered for New York pensioners, though not always for the retirees in other systems. NYSERS has so far avoided the chronic underfunding and high-risk investments that have led many public pensions into crisis.[69]

---

[68] United States Department of Health, Education, and Welfare, *School Bond Sales for Public Purposes*, 11; Robert R. Douglass Files, Series 10, Rockefeller Archive Center, Lewis Bart Stone to Robert R. Douglass, Memo: "State Bonding Authority for School District Bonds," 2, Oct. 2, 1969, folder 162, box 15; New York State Commission on the Quality, Cost and Financing of Elementary and Secondary Education, *Final Report*, 2D.2, 2.65-2.67; New York Department of Audit and Control, *Financial Data for School Districts* (1971), v.

[69] Richard Phalon, "State Pension Fund Wants Stock Seat," *New York Times*, Mar. 3, 1971, p. 57; "A Report on Ten Other State Pension Funds," *Institutional Investor* (Feb. 1970), 45-47; Munnell, *State and Local Pensions*. On the rise of "shareholder value," see Davis, *Managed by the Markets*.

Instead of being bound together in a shared project of social welfare provision, pensions and schools both grew more dependent on markets during the postwar era. Their fates diverged, as pension deregulation benefited state retirees at the expense of perpetually indebted school districts. This divergence was a long-term process, the culmination of choices made during the prosperous 1950s, and not simply a reaction to the overlapping crises of the 1970s. In this light, later events, like the New York City fiscal crisis, which are often depicted as signaling the arrival of a new neoliberal era, are better understood as the outgrowth of gradual institutional changes. In other words, the fiscal crisis did not create the public dependence on private capital. It merely revealed the dependence that had been growing for decades. Excavating the regime of fiscal mutualism, then, is a call for scholars to look more closely at liberalism when it seemed to be functioning as they seek to explain why many of its promises have since collapsed.[70]

[70] On the New York City fiscal crisis, see Phillips-Fein, *Fear City*. For a similar argument about long-term processes, see Cebul, Geismer, and Williams, "Beyond Red and Blue."

References

Allen, James E. New York State Education Department Commissioner Subject Files. New York State Archives. Albany, NY.

Andrews, Victor. "Noninsured Corporate and State and Local Government Retirement Funds in the Financial Structure." In *Private Capital Markets: A Series of Research Prepared for the Commission on Money and Credit*, ed. Irwin Friend, Hyman Minsky, and Victor Andrews, 381-531. Englewood Cliffs, NJ: Prentice-Hall, 1964.

Balogh, Brian. *A Government Out of Sight: The Mystery of National Authority in Nineteenth-Century America*. New York: Cambridge University Press, 2009.

Balogh, Brian. *The Associational State: American Governance in the Twentieth Century*. Philadelphia: University of Pennsylvania Press, 2015.

Biondi, Martha. *To Stand and Fight: The Struggle for Civil Rights in Postwar New York City*. Cambridge, MA: Harvard University Press, 2003.

Brinkley, Alan. *The End of Reform: New Deal Liberalism in Recession and War*. New York: Alfred A. Knopf, 1995.

Calvert, Gordon. *State Pension Funds: Digest of Authorized Investments and Actual Investments*. Washington, DC: Investment Bankers of America, 1962.

Canaday, Margot. *The Straight State: Sexuality and Citizenship in Twentieth-Century America*. Princeton: Princeton University Press, 2009.

Cebul, Brent, Karen Tani, and Mason Williams. "Clio and the Compound Republic." *Publius: The Journal of Federalism* 47, no. 2 (2017): 235-59.

Cebul, Brent, Lily Geismer, and Mason B. Williams. "Beyond Red and Blue: Crisis and Continuity in Twentieth-Century U.S. Political History." In *Shaped by the State: Toward a New Political History of the Twentieth Century*, ed. Brent Cebul, Lily Geismer, and Mason B. Williams. Chicago, University of Chicago Press, 2019.

Cebul, Brent. "Creative Competition: Georgia Power, the Tennessee Valley Authority, and the Creation of a Rural Consumer Economy, 1934-1955." *Journal of American History* 105, no. 1 (2018): 45-70.

Clark, Robert, Lee Craig, and Jack Wilson. *A History of Public Sector Pensions in the United States*. Philadelphia: University of Pennsylvania Press, 2003.

Cohen, Lizabeth. *A Consumer's Republic: The Politics of Mass Consumption in Postwar America*. New York: Alfred A. Knopf, 2003.

Correspondence, Speech, and Report Files. New York State Department of Audit and Control. New York State Archives. Albany, NY.

Crowder, William and Mark Wohar. "The Changing Long-Run Linkage between Yields on Treasury and Municipal Bonds and the 1986 Tax Act." *Review of Financial Economics* 8, no. 2 (1999): 101-19.

Davis, Gerald F. *Managed by the Markets: How Finance Reshaped America*. New York: Oxford University Press, 2009.

Derthick, Martha. *Keeping the Compound Republic: Essays on American Federalism*. Washington, DC: Brookings Institution Press, 2001.

Douglass, Robert R. Files. Rockefeller Archive Center, Tarrytown, NY.

Freund, David. *Colored Property: State Policy and White Racial Politics in Suburban America*. Chicago: University of Chicago Press, 2007.

Friedman, Milton and Anna Jacobson Schwartz. *A Monetary History of the United States, 1867-1960*. Princeton: Princeton University Press, 1971.

Glotzer, Paige. *How the Suburbs Were Segregated: Developers and the Business of Exclusionary Housing, 1890-1960*. New York: Columbia University Press, 2020.

Government Statistical Corporation. *The School Districts of Nassau County, Their Statistics and Finances*. New York, 1950.

Governor's Committee on the Marketing of School Bonds. *Final Report: Schools for New York*. Albany, 1957.

Grosh, D. "Trustee Investment: English Law and the American Prudent Man Rule." *The International and Comparative Law Quarterly* 23, no. 4 (1974): 748-768.

Hacker, Jacob. *The Divided Welfare State: The Battle Over Public and Private Social Benefits in the United States*. New York: Cambridge University Press, 2002.

Hirsch, Arnold R. "Choosing Segregation: Federal Housing Policy Between *Shelley* and *Brown*." In *From Tenements to the Taylor Homes: In Search of an Urban Housing Policy in Twentieth-Century America*, ed. John F. Bauman, Roger Biles, and Kristin Szylvian, 206-25. University Park: Pennsylvania State University Press, 2000.

Hockett, Robert and Saule Omarova. "'Private' Means to 'Public' Ends: Governments as Market Actors." *Theoretical Inquiries in Law* 15, no. 1 (2014): 53-76.

Homer, Sidney. "Factors Determining Municipal Bond Yields." In *State and Local Public Facility Needs and Financing: Volume 2, Public Facility Financing,* 269-298. Washington, DC: Government Printing Office, 1966.

Jackson, Kenneth. *Crabgrass Frontier: The Suburbanization of the United States*. New York: Oxford University Press, 1985.

Kane, Muriel and Julian Collection. Stony Brook University Special Collections and University Archives. Stony Brook, NY.

Katznelson, Ira. *When Affirmative Action Was White: An Untold History of Racial Inequality in Twentieth-Century America*. New York: W.W. Norton, 2005.

Kessler-Harris, Alice. *In Pursuit of Equity: Women, Men, and the Quest for Economic Citizenship in 20th-Century America*. New York: Oxford University Press, 2001.

Klein, Jennifer. *For All These Rights: Business, Labor, and the Shaping of America's Public-Private Welfare State*. Princeton: Princeton University Press, 2003.

Levitt, Arthur. "Tight Money and Municipal Borrowing." *Municipal Finance* 30, no. 1 (1957): 18-22.

-----. Oral History Project. Hamilton University Special Collections. Clinton, New York.

Martin, Isaac William. *The Permanent Tax Revolt: How the Property Tax Transformed American Politics*. Stanford: Stanford University Press, 2008.

McCarthy, Michael. *Dismantling Solidarity: Capitalist Politics and American Pensions since the New Deal*. Ithaca: Cornell University Press, 2017.

McCartin, Joseph A. "'A Wagner Act for Public Employees': Labor's Deferred Dream and the Rise of Conservatism, 1970-1976." *Journal of American History* 95, no. 1 (2008): 123-48.

McGee, Cushman. "Investments of Retirement Systems." *Municipal Finance* 16, no. 3 (1944): 16-21.

Meriam, Lewis. *Principals Governing the Retirement of Public Employees*. New York: Appleton and Company, 1918.

Municipal Finance Commission. *Local Finance Law: Handbook for School Districts*. Albany, 1947.

Munnell, Alicia Haydock. *State and Local Pensions: What Now?* Washington, DC: Brookings Institution Press, 2012.

Nassau County Comptroller's Office. *Five Year Cumulative Report of County of Nassau, New York and All Municipal Subdivisions Showing Indebtedness, Assessed Values, Tax Levies, Tax Rates*. Mineola, New York, various years.

New York Department of Audit and Control. *Financial Data for School Districts—Year Ending June 30, 1971*. Albany, 1971.

New York State Assistant Secretary to the Governor Subject Files. New York State Archives. Albany, NY.

New York State Commission on School Buildings. *More Schools for Your Money: Finance Handbook*. Albany, 1954.

New York State Commission on School Buildings. *The School Building Problem in New York State*. Albany, 1951.

New York State Commission on the Quality, Cost and Financing of Elementary and Secondary Education, *Final Report*. Albany, 1972.

New York State Comptroller's Office. *Annual Report of the Comptroller*. Albany, various years.

New York State Education Department Division of Research. *School District Voting in 1958-1959 School Year, Bond and Budget Referendums*. Albany, 1959.

New York State Education Department. *Forty-Eighth Annual Report of the Education Department for the School Year Ending June 30, 1951*. Albany, 1952.

New York University. *Levittown's Schools and the Future of the Community: A Survey by the Center for Community and Field Services*. New York, 1954.

Offner, Amy. *Sorting Out the Mixed Economy: The Rise and Fall of Welfare and Developmental States in the Americas*. Princeton: Princeton University Press, 2019.

Ott, Julia. "Tax Preference As White Privilege in the United States, 1921-1965." *Capitalism: A Journal of History and Economics* 1, no. 1 (2019): 92-165.

Ottaviano, John Jr. "Investment of Trust and Pension Funds." *Report of the Forty-Third Annual Convention of the National Association of State Auditors, Comptrollers, and Treasurers* 43 (1958): 161-167.

Patterson, James. *Grand Expectations: The United States, 1945-1974*. New York: Oxford University Press, 1996.

Phillips-Fein, Kim. *Fear City: New York's Fiscal Crisis and the Rise of Austerity Politics*. New York: Metropolitan Books, 2017.

Podell, Bertram L. Papers. M.E. Grenander Department of Special Collections and Archives. University at Albany. Albany, NY.

Radford, Gail. *The Rise of the Public Authority: Statebuilding and Economic Development in Twentieth-Century America*. Chicago: University of Chicago Press, 2013.

Redfield, Charles. "The Impact of Levittown on Local Government." *Journal of the American Institute of Planners* 17, no. 3 (1951): 130-41.

Robinson, Roland I. *Postwar Market for State and Local Government Securities*. Princeton: Princeton University Press, 1960.

Rome, Adam. *The Bulldozer in the Countryside: Suburban Sprawl and the Rise of American Environmentalism*. New York: Cambridge University Press, 2001.

Romer, Christina and David Romer. "The Incentive Effects of Marginal Tax Rates: Evidence from the Interwar Era." *American Economic Journal: Economic Policy* 6, no. 3 (2014): 242-281.

Sbragia, Alberta. "Borrowing to Build: Private Money and Public Welfare." *International Journal of Health Services* 9, no. 2 (1979): 207-26.

Scheiber, Harry. "Government and the Economy: Studies of the 'Commonwealth' Policy in Nineteenth-Century America." *The Journal of Interdisciplinary History* 3, no. 1 (1972): 135-51.

Self, Robert. *American Babylon: Race and the Struggle for Postwar Oakland*. Princeton: Princeton University Press, 2003.

Slater, Joseph E. *Public Workers: Government Employee Unions, the Law, and the State, 1900-1962*. Ithaca: Cornell University Press, 2004.

Sligh, John and Thomas Taylor. "Statutory Note: Trustee Investment—Legal List." *Mercer Law Review* 15, no. 2 (1964): 530-34.

Sparrow, James. *Warfare State: World War II Americans and the Age of Big Government*. New York: Oxford University Press, 2011.

State of New York Commission on Pensions. *Report of the State Commission on Pensions on Advisability of Coordinating Social Security Coverage and Benefits Provided by Public Employee Pensions in New York State*. Albany, 1955.

State of New York. *Report of the Commission on Pensions* (Legislative Document No. 92). Albany: 1920.

Sterett, Susan M. *Public Pensions: Gender and Civic Service in the States, 1850-1937*. Ithaca: Cornell University Press, 2003.

Stevenson, Alec. "Why the Prudent Man." *Vanderbilt Law Review* 7, no. 1 (1953): 74-92.

Sugrue, Thomas J. *Sweet Land of Liberty: The Forgotten Struggle for Civil Rights in the North*. New York: Random House, 2008.

Temporary Commission on Educational Finances. *Final Report: Financing Public Education in New York State*. Albany, 1956.

Tilove, Robert. *Public Employee Pension Funds: A Twentieth Century Fund Report*. New York: Columbia University Press, 1976.

Tremaine, Morris. "New York's FHA Mortgage Investments." *Insured Mortgage Portfolio* 3, no. 1 (1939): 3-4, 20-21.

Union Free School District 5 Minutes. Levittown Public Library. Levittown, NY.

United States Department of Commerce, Bureau of the Census. *Historical Statistics of the United States, Colonial Times to 1970, Ch. X, Financial Markets and Institutions*. Washington, DC: Government Printing Office, 1975.

United States Department of Health, Education, and Welfare. *School Bond Sales for Public Purposes: 1969-1970*. Washington, DC, 1969.

Wilson, Lewis A. New York State Education Department Commissioner Subject Files. New York State Archives. Albany, NY.

Yinger, John. "Municipal Bond Ratings and Citizens' Rights." *American Law and Economics Review* 12, no. 1 (2010): 1-38.