THE FRAIL BONDS OF LIBERALISM: PENSIONS, SCHOOLS, AND THE UNRAVELING OF FISCAL MUTUALISM IN MIDCENTURY NEW YORK

Michael R. Glass, Princeton University (mrglass@princeton.edu)
Sean H. Vanatta, New York University (sean.vanatta@nyu.edu)

DRAFT – Please contact the authors before quoting, citing, etc.

Between 1940 and 1965, state-level officials changed the relationship between two pillars of the postwar social contract: modern public schools and secure retirement. The result was the unravelling of what we call "fiscal mutualism," an investment regime in which government officers funneled public savings into governmental securities, using these investments to underwrite public infrastructure. Fiscal mutualism was a common investment strategy during the early twentieth century, but by the 1960s pension managers had completely abandoned it, with dramatic consequences for local governments. We show this transformation through a close examination of pension fund investment in New York State. Throughout the 1950s, the comptrollers who managed the New York State Employee Retirement System (NYSERS), the largest state pension system in the nation, subsidized the costs of public-school construction by purchasing the bonds of suburban school districts. However, in response to changes in national political economy, as well as to evolving norms of "fiduciary duty" that prioritized maximum returns over absolute security, New York Comptroller Arthur Levitt, Sr., lobbied the state legislature to deregulate the pension's investment powers. After securing these regulatory changes, Levitt steadily disinvested the pension's municipal bond holdings in favor of higher-yielding corporate securities. In doing so, he secured higher investment returns for retirees, tying their economic security to fluctuations in private financial markets. By contrast, New York's school boards were left to confront bond markets and rising interest rates without the backstop of fiscal mutualism. As school budgets, and the property taxes that supported them, became freighted with expensive interest payments, tax revolts became a permanent response to financialized public policy. Thus, the unraveling of fiscal mutualism, we demonstrate, is consistent with the process scholars now call "financialization," although we argue that financialization began earlier and under different economic conditions than scholars have yet realized.

In May 1959, New York State Comptroller Arthur Levitt, Sr., met with a distinguished group of financial executives at the downtown office of Goldman Sachs & Company. The meeting was the first between the state's chief financial officer and the new Investment Advisory Council, which Levitt assembled to help transform the state's $1.2 billion retirement portfolio. Levitt intended a major change in investment objectives. With the bankers' encouragement, he planned to sell the one-third of pension assets invested in municipal bonds and reinvest the receipts into higher-yielding private mortgages and corporate securities. The shift would have immediate consequences for school districts across the state. Over the previous decade, New York comptrollers had subsidized public school construction in booming suburbs by purchasing school bonds with pension funds. Following his advisers' counsel, Levitt would steadily disinvest the New York State Employee Retirement System (NYSERS) from municipal bonds in favor of private securities, shifting the pension's investment strategy from socializing investment returns to seeking maximum yield for state retirees in private capital markets (fig. 1).[1]

The meeting thus marked a decisive shift in priorities. Under the previous investment regime, which we call *fiscal mutualism*, state officials funneled pension savings into governmental securities, using these investments to underwrite civic infrastructure. Of course, such recycling of public money into public projects 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. Yet over the twentieth century, as retirement systems accumulated the savings of government workers, pensions became an especially powerful tool for promoting public objectives. By the 1940s, pension

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

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 subsidized the construction of roads, sewers, schools, and other civic projects that depended on bond markets for capital financing. Through these investments, fiscal mutualism provided pensioners with safe, consistent returns for their retirement accounts. Its political and economic logics reinforced one another, and this relationship was legally codified: before World War II, most states restricted public pension investments to federal, state, and local bonds.[2]

A governing practice rooted in federalist institutions, fiscal mutualism became foundational to liberal statebuilding during the New Deal and, especially, the postwar era. At the national level, policymakers crafted "grand expectations" for postwar abundance, but they delegated the policy implementation to local governments and the bond markets these governments 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 providing public services in newly built suburbs like Levittown, New York. The costliest of these, public education, became an unfunded mandate that stretched the fiscal capacity of suburban districts. State and local officials met the school-building crisis by turning to pension funds. During the 1950s, New York comptrollers purchased school bonds to subsidize school construction,

[2] For an overview of foundational works on state-led development, see Harry Scheiber, "Government and the Economy: Studies of the 'Commonwealth' Policy in Nineteenth-Century America," *The Journal of Interdisciplinary History*, 3 (Summer 1972), 135-51. For the state pension figures, see Victor Andrews, "Noninsured Corporate and State and Local Government Retirement Funds in the Financial Structure," in Irwin Friend, Hyman Minsky, and Victor Andrews, *Private Capital Markets: A Series of Research Prepared for the Commission on Money and Credit* (Englewood Cliffs, NJ, 1964), 381-382.

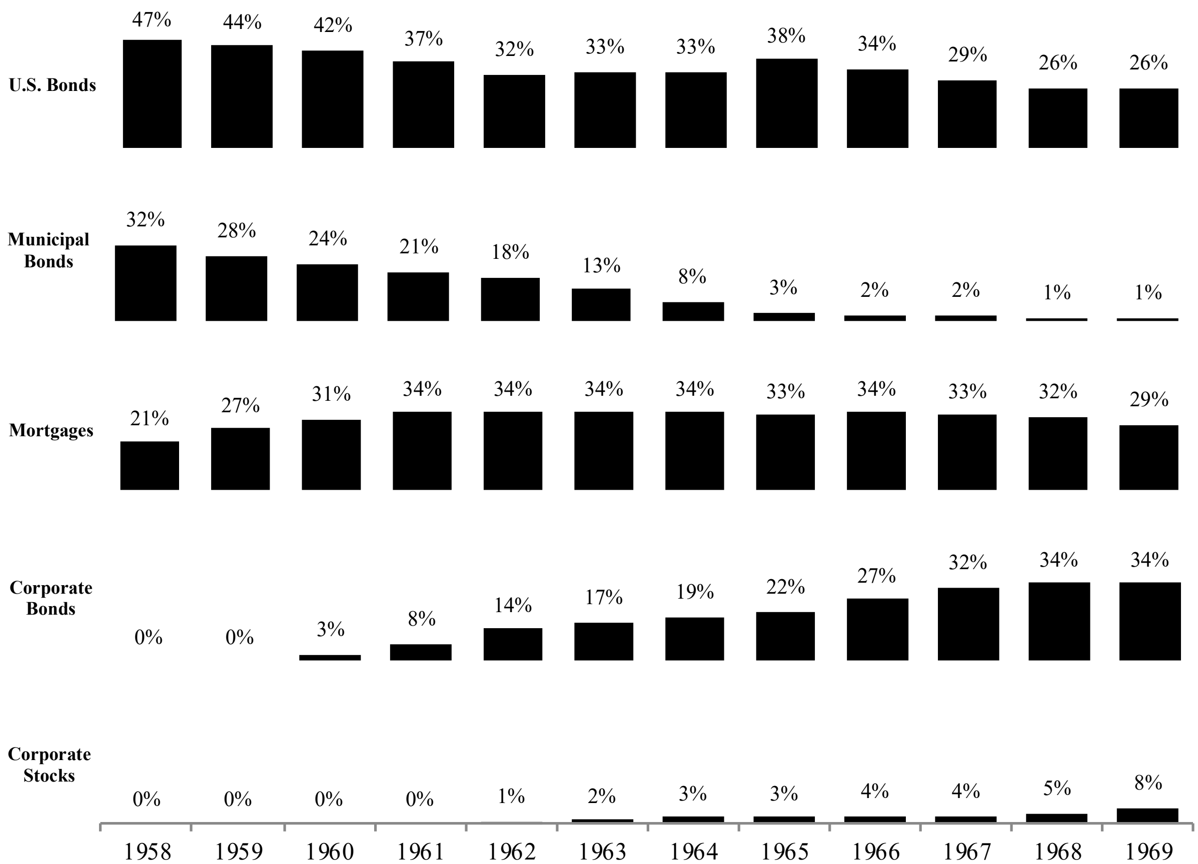
leveraging the market power of pension systems to hold down interest rates. Fiscal mutualism, in short, helped turn the lofty promises of suburbia into concrete realities.[3]

But changes in national political economy and shifts in the assumptions guiding pension stewardship spelled the downfall of fiscal mutualism. The rise of mass income taxation during World War II widened the yield spread between tax-exempt public and taxable private securities, such that municipal bonds offered significantly lower returns than similar private investments. Meanwhile, an evolving ideology of "fiduciary duty," which prioritized maximum returns over absolute safety, compounded this relative disadvantage. In this context, the interests of schools and pensions were increasingly at odds: whereas school districts sought the lowest possible interest rates on their bond issues, pensioners were entitled to the highest possible yields for their retirement accounts. As Levitt explained to the Investment Advisory Council, this dual public obligation—to local governments, as the state's chief fiscal officer, and to retirees, as the trustee of their pensions—presented him, as comptroller, with "perplexing questions of policy." State officials ultimately resolved these questions by deregulating public pensions, allowing pension trustees to abandon local investment in favor of higher-yielding corporate securities. Whereas in 1941 state and local bonds comprised 76 percent of all public pension assets nationwide, by 1957 the figure had dropped to 26 percent. By 1973, it was just 2 percent. In state offices across the country, the economic logic of market returns overruled the political logic of reciprocal investment, unraveling the regime of fiscal mutualism.[4]

---

[3] James Patterson, *Grand Expectations: The United States, 1945-1974* (New York, 1996). Studies that document the federal underwriting of suburbia rarely address infrastructure finance. See Kenneth Jackson, *Crabgrass Frontier: The Suburbanization of the United States* (New York, 1985); Lizabeth Cohen, *A Consumer's Republic: The Politics of Mass Consumption in Postwar America* (New York, 2003); David Freund, *Colored Property: State Policy and White Racial Politics in Suburban America* (Chicago, 2007). For an exception, see Adam Rome, *The Bulldozer in the Countryside: Suburban Sprawl and the Rise of American Environmentalism* (New York, 2001), esp. 87-118. We are indebted to Brent Cebul for the formulation of school construction as an "unfunded mandate."
[4] Minutes, Meeting of Comptroller's Investment Advisory Council, May 27, 1959, "Retirement—Investment Adv. Comm." folder, box 3, Levitt files; "Retirement Funds in the Financial Structure," 411-414; Robert Tilove, *Public*

Fig 1. **NYSERS Assets by Category, 1958-1969**



Source: New York State, Department of Audit and Control, *Annual Report of Comptroller* (published annually)

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. In doing so, we provide a new vantage point on the conflicts over public and private welfare provision at the heart of liberal statecraft. To be a full citizen in postwar America was to expect rising wages, subsidized homeownership, a lifestyle of bountiful consumption, and economic security in old age. While scholars have analyzed how

Employee Pension Funds: A Twentieth Century Fund Report (New York, 1976), 204-205. On the rise of the federal tax state, see James Sparrow, *Warfare State: World War II Americans and the Age of Big Government* (New York, 2011). On the 1950s deregulation of public pensions, see Michael McCarthy, *Dismantling Solidarity: Capitalist Politics and American Pensions since the New Deal* (Ithaca, 2017).

groups were excluded from these privileges on the basis of gender, race, and sexuality, they have paid less attention to the mechanisms that provided those benefits to the most privileged recipients. With its fusion of state pensions and local infrastructure, fiscal mutualism underscores the extent to which liberal state-builders, faced with the constraints of the federalist political structure, utilized market mechanisms to allocate social benefits. Indeed, fiscal mutualism made use of markets; it did not supplant them. Although pensions were never the only buyer of municipal bonds, comptrollers were decisive market actors who used bond markets as a private means to support the public ends of school construction. They wielded the immense purchasing power of pension funds to hold down school bond interest rates. In doing so, they played an essential role in delivering liberalism's grand expectations, albeit *through* markets.[5]

Comptroller Levitt's efforts to remove himself from the competing claims of schools and pensions is consistent with the process scholars now call "financialization." Most studies point to economic restructuring in the 1970s as the catalyst for the rise of the financial sector and the offloading of public functions into the realm of market relations. Our investigation, however, shows that financialization was a continuous, accelerating process throughout the postwar era. During the unprecedented economic prosperity of the 1950s, state-level policymakers

[5] For a useful theorization of governments as market actors, see Robert Hockett and Saule Omarova, "'Private' Means to 'Public' Ends: Governments as Market Actors," *Theoretical Inquiries in Law* 15, (2014), 53-76. For historical studies on the role of markets in American state development, see Brian Balogh, *A Government Out of Sight: The Mystery of National Authority in Nineteenth-Century America* (New York, 2009); Gail Radford, *The Rise of the Public Authority: Statebuilding and Economic Development in Twentieth-Century America* (Chicago, 2013); Brent Cebul, "Creative Competition: Georgia Power, the Tennessee Valley Authority, and the Creation of a Rural Consumer Economy, 1934-1955," *Journal of American History* 105, (June 2018), 45-70. On the blended, federalist structure of the American welfare state, see Jacob Hacker, *The Divided Welfare State: The Battle Over Public and Private Social Benefits in the United States* (New York, 2002); Jennifer Klein, *For All These Rights: Business, Labor, and the Shaping of America's Public-Private Welfare State* (Princeton, 2003); Brent Cebul, Karen Tani, and Mason Williams, "Clio and the Compound Republic," *Publius: The Journal of Federalism,* 47 (2017), 235-59. On group-based welfare state exclusions, see Alice Kessler-Harris, *In Pursuit of Equity: Women, Men, and the Quest for Economic Citizenship in 20th-Century America* (New York, 2001); Ira Katznelson, *When Affirmative Action Was White: An Untold History of Racial Inequality in Twentieth-Century America* (New York, 2005); Margot Canaday, *The Straight State: Sexuality and Citizenship in Twentieth-Century America* (Princeton, 2009).

fundamentally changed how they thought about financial markets, reimagining how those markets could be used to enact their policy goals. Pension deregulation allowed comptrollers to, as sociologist Greta Krippner describes the 1970s turn to finance, "extricate themselves from a series of political dilemmas." Instead of negotiating the competing policy priorities themselves, as they had under fiscal mutualism, after deregulation comptrollers could abdicate the toughest choices to the market. The unraveling of fiscal mutualism thus set state and local governments on the path to market dependence, and it did so earlier, and under different economic conditions, than scholars have realized. This state-level financialization created clear winners and losers. While state retirees benefited from pension deregulation through higher returns on their retirement accounts, suburban homeowners paid for their exposure to the bond market with higher taxes, driven in part by rising interest rates on municipal bonds. A direct response to the financialization of public infrastructure, school tax revolts, like the one that rocked New York in May 1959, became a permanent feature of suburban politics.[6]

In what follows, we examine financialization from the perspective of the comptroller's desk, the fulcrum from which Levitt unraveled fiscal mutualism. First, we begin by briefly outlining the early twentieth century regime of fiscal mutualism, before showing how the crisis of suburban school construction stretched this regime to its breaking point. From there, we closely examine the investment decisions of various comptrollers as they tried to balance the competing demands of school districts and pensioners. The fraying economic logic of mutual

[6] Greta Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge, MA, 2011), 27; "Taxpayer Revolt Seen in L. I. Votes," *New York Times*, May 8, 1959, p. 18. For other studies locating financialization in the 1970s, see Gerald Davis, *Managed by the Markets: How Finance Reshaped America* (New York, 2009); Judith Stein, *Pivotal Decade: How the United States Traded Factories for Finance in the Seventies* (New Haven, 2010). Most scholars have interpreted the tax revolts as either a backlash against racial liberalism or an attempt to restore informal tax privileges encoded in assessment practices. For each interpretation, see Robert Self, *American Babylon: Race and the Struggle for Postwar Oakland* (Princeton, 2003); Isaac William Martin, *The Permanent Tax Revolt: How the Property Tax Transformed American Politics* (Stanford, 2008).

investment led Levitt to begin lobbying for deregulation, and in the concluding sections we trace the consequences of the pension diversification for retirees, school districts, and the fate of postwar liberalism more broadly. Levitt did continue seeking liberal policy priorities, albeit through markets, and state pensioners did materially benefit from higher returns. The tradeoff was that the state abandoned its direct role in shaping the municipal bond market.

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. In 1920, New York legislators created NYSERS to replace a patchwork of state and municipal pension schemes, organizing the fund on an actuarial reserve basis. The state accumulated a reserve from 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.[7]

The comptroller invested NYSERS's assets within a set of legal rules designed to both encourage financial safety and subsidize local infrastructure. Following regulations common to

[7] Robert Clark, Lee Craig, and Jack Wilson, *A History of Public Sector Pensions in the United States* (Philadelphia, 2003), 167-202; State of New York, *Report of the Commission on Pensions*, Legislative Document No. 92 (Albany, 1920); Tilove, *Public Employee Pension Funds*, 290.

most public pensions, New York law proscribed a legal list of sanctioned investments, limiting NYSERS's assets 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." Through these investments, Tremaine supported the 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.[8]

Economic objectives reinforced the political logic of mutual investment. Through the end of World War II, state pension managers prioritized safe returns over maximum yields. Pension trustees developed this ideology through professional organizations such as the Municipal Finance Officers Association, and its journal, *Municipal Finance*, where public officials and private financiers alike defended the efficacy of local investments. Pension beneficiaries "are the public officers and employees who can largely influence the fiscal policies of the debtor municipality," argued Cushman McGee, a New York investment banker, 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

---

[8] Clark, Craig, and Wilson, *A History of Public Sector Pensions*, 203-217; Gordon Calvert, *State Pension Funds: Digest of Authorized Investments and Actual Investments* (Washington, 1962); *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 Alec Stevenson, "Why the Prudent Man," *Vanderbilt Law Review*, 7 (Dec. 1953), 74-92; John Sligh and Thomas Taylor, "Statutory Note: Trustee Investment—Legal List," *Mercer Law Review*, 15 (no. 2, 1964), 530-34.

investment objective. By creating layers of reciprocal obligation, fiscal mutualism secured municipal bond investments. Within this legal and intellectual framework, pension trustees funneled pension funds into state and local securities, which comprised 76 percent of public pension assets nationwide in 1941, and 85 percent of those held by NYSERS.[9]

Despite its political and economic advantages, fiscal mutualism contained a built-in weakness. Because municipal bond interest payments are exempt from federal taxation—a feature codified with the establishment of the federal income tax in 1913—they tend to offer lower yields than similarly risky private securities. Investors subject to federal income taxes compensate for these lower yields with tax savings; the effective tax rate is thus a prime determinant of the yield difference between taxable and non-taxable securities. Public pensions, however, are not taxed, meaning the tax benefits of municipal bonds do not accrue to pensioners. Before World War II, low federal tax rates meant the yield differentials were not substantial. Concern that municipal bonds might offer below-market returns for pensioners only became important after the rise of mass income taxation. Throughout the early twentieth century, fiscal mutualism remained politically and economically sound from the comptroller's desk.[10]

Yet as yields on municipal bonds declined, it began to strain the symbiotic relationship between state investors and local borrowers. In New York, the state's guarantee of 4 percent interest on employee contributions initially provided a ceiling on the returns the state needed to achieve to meet its pension obligations. The portfolio of state and municipal securities consistently yielded around 4.5 percent in the early 1930s, allowing comptrollers to pursue

[9] Clark, Craig, and Wilson, *A History of Public Sector Pensions*, 203-217; Lewis Meriam, *Principals Governing the Retirement of Public Employees* (New York, 1918), 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.

[10] Christina Romer and David Romer, "The Incentive Effects of Marginal Tax Rates: Evidence from the Interwar Era," *American Economic Journal: Economic Policy*, 6 (Aug. 2014), 278-279; Clark, Craig, and Wilson, *A History of Public Sector Pensions*, 205, 212.

investments that were advantageous to its subdivisions. The interest ceiling, however, soon began to look more like a hard floor. "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. Yet even with these new investments, Tremaine kept using state funds to promote local economic development, deciding to limit the mortgage purchases to "property located within the state."[11]

The bright spot of mortgage investments only lasted until war mobilization demanded a greater share of financial resources. Local governments, moreover, delayed capital expenditures, and municipal bond yields stagnated. As the war progressed, comptrollers shifted pension assets into federal bonds, which offered both higher yields and the opportunity to maintain investments in state capacity, now with a national rather than local emphasis. U.S. securities 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 U.S. 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 from 4 percent to 3 percent, since higher investment yields no longer seemed attainable.[12]

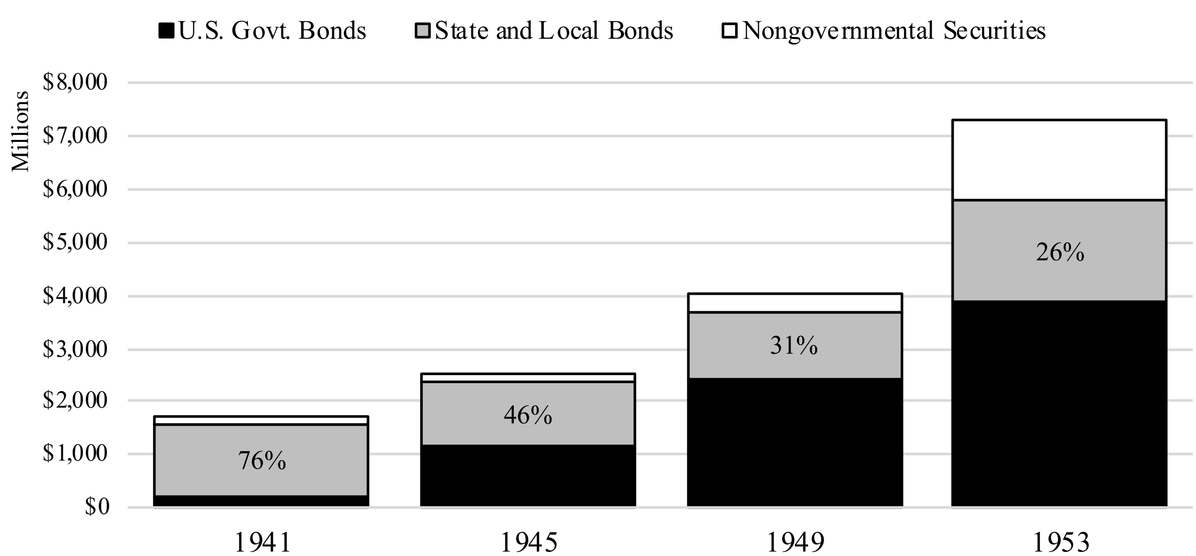
Although state fiscal officers looked hopefully to the postwar era, when pent-up capital projects would generate new outlets for local investment, the demands of war finance fundamentally changed the economic logic undergirding fiscal mutualism. In 1942, Congress

[11] *Annual Report of the Comptroller* (1935), xx, 290-300; *Annual Report of the Comptroller* (1937), xxi, 292; Morris Tremaine, "New York's FHA Mortgage Investments," *Insured Mortgage Portfolio*, 3 (Feb. 1939), 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.

[12] *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.

significantly hiked the income tax rates on the nation's highest earners, causing the yield spread between taxable and non-taxable bonds to diverge sharply. After the war, the municipal bond yields remained stubbornly below 2 percent—rates still appealing for wealthy individuals in high tax brackets, but far below what pension trustees needed to achieve. As a result of the tax differential, pension investments began shifting away from municipal bonds. Public pension trustees, where authorized to do so, started buying non-governmental securities. In New York, the comptroller returned to buying FHA mortgages, expanding NYSERS holdings of mortgages from less than 4 percent of the portfolio in 1948 to over 20 percent in 1951. As a percentage of nationwide pension assets, private securities jumped from 6 percent to 14 percent over the same period, beginning a trajectory that would continue over subsequent decades.[13]

Fig 2. **Distribution of Assets for State and Local Employee Retirement Funds**
with percentage invested in State and Local Bonds



Source: Andrews, "Noninsured Corporate and State and Local Government Retirement Funds," 526-528.

[13] Clark, Craig, and Wilson, *A 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; *Annual Report of the Comptroller* (1948), 98; *Annual Report of the Comptroller* (1951), 95.

Meanwhile, the same low interest rates that made municipal bonds unappealing for pension funds encouraged state and local governments to borrow, building expectations for postwar prosperity underwritten by cheap credit. These grand expectations were another consequence of war finance. 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. As a result of this so-called "Fed-Treasury Accord," the Federal Reserve reasserted its authority over inflation by deliberately hiking interest rates. As the Fed began to battle inflation in earnest, it raised the cost of local borrowing, threatening the liberal ambitions for postwar prosperity.[14]

In sum, the economic logic of fiscal mutualism was disrupted on two fronts. First, municipal bond yields dipped below the level pensions needed to maintain guarantees to pensioners. Second, higher federal income taxes widened the differential between municipal bonds and corporate securities. Although Fed policy eventually drove yields back up, the differential persisted, and with it, doubts about whether local investment was so virtuous after all. Nevertheless, the political logic of fiscal mutualism remained sound; in fact, it grew stronger as the demands of the affluent society collided with higher borrowing costs. Across the country, pensions kept investing in local infrastructure, maintaining a sizeable share of the municipal bond market. But the fraying economic logic of fiscal mutualism opened space for new ideas about fiduciary duty that emphasized maximum yields over prudent returns.[15]

---

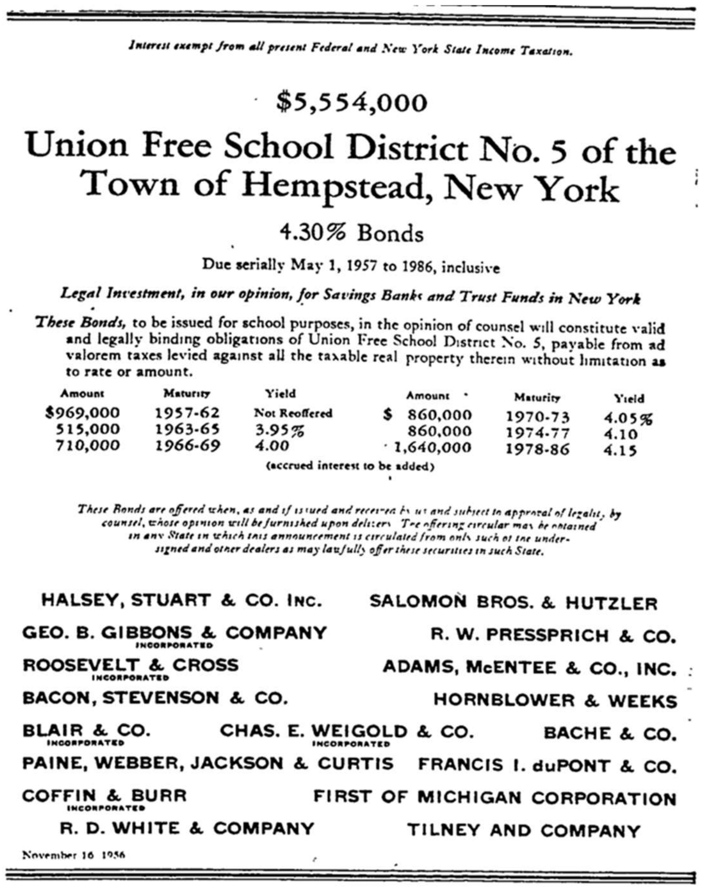
[14] Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton, 1971), 593-638, passim.
[15] Andrews, "Retirement Funds in the Financial Structure," 489-492.

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 already 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 could not 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.[16]

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 pay an additional $1.4 million just on interest payments, a sum equivalent to the price of a 900-pupil elementary school. For Levittown and other rapidly growing districts across the country, rising interest rates amounted to a slow-motion disaster.[17]

[16] "Levittown Plans A $5,554,000 Issue," *New York Times*, Nov. 8, 1956, p. 60; Municipal Finance Commission, *Local Finance Law: Handbook for School Districts* (Albany, 1947), 20-21.
[17] "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.


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

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.[18]

The school construction crisis hit especially hard in Levittown. The federal government underwrote the entire 17,447-house development by insuring the mortgages in advance. Yet 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. The largest oversight concerned the schools. 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 that the schools were already built. Upon arriving, homebuyers 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.[19]

The dearth of school facilities proved 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; despite 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

---

[18] The State Education Department, *Forty-Eighth Annual Report of the Education Department for the School Year Ending June 30, 1951* (Albany, 1955), 41; Val Duncan, "LI Schools Face Teacher Shortage, Overcrowding," *Newsday,* Sep. 3, 1953, p. 44.

[19] Charles Redfield, "The Impact of Levittown on Local Government," *Journal of the American Institute of Planners*, 17 (Summer 1951), 130-141; Patterson, *Grand Expectations,* 70-75; Levitt & Sons, "$58!," advertisement, *New York Times*, Nov. 20, 1949, p. R3; Eleanor K. Brownell, "Report to the Board at Regular Meeting," Aug. 27, 1952; Minutes of Special Meeting, Oct. 8, 1952, U.F.S.D. 5 Board Minutes, reel 1, Levittown Public Library.

opening day. By 1953, Frederick Tilney, a school finance consultant, saw no end in sight to the crisis: "With some 10,000 houses going up every year, we can expect an increase of 13,000 new kiddies annually."[20]

All the "new kiddies" needed 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 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 the next thirty years. Borrowing to build, voters mortgaged their collective future to pay for new schools in the present. But there was a hitch in the process. After voter approval, officials were allowed two years to advertise the issue to investors, creating a window to float the bond when market conditions proved most favorable. Voters, therefore, had no idea what the final interest rate would be when they approved the loan. That came years later, sealed in envelopes.[21]

Just as school officials turned to the bond market, interest rates began creeping upwards. In the decade after World War II, 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:

---

[20] "173 Enrolled in 1898 School Built for 20," *Newsday*, Feb. 9, 1951, p. 7; Alfred G. Berner to James A. Webb, Oct. 19, 1951; Florence Virrick to Lewis E. Wilson, Oct. 27, 1951, folder 2, box 30, NYS Education Department Commissioner Lewis A. Wilson Subject Files, NYSA; Val Duncan, "LI Schools Face Teacher Shortage, Overcrowding," *Newsday,* Sep. 3, 1953, p. 44.

[21] *The School Building Problem in New York State: Second Report of the Commission on School Buildings of the State of New York* (Albany, 1951), 6-7; New York State Commission on School Buildings, *More Schools for Your Money: Finance Handbook* (Albany, 1954), 22-47; Alberta Sbragia, "Borrowing to Build: Private Money and Public Welfare," *International Journal of Health Services*, 9 (1979), 207-226.

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, borrowers were forced to pay higher rates to keep enticing new investors. 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.[22]

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 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: 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

[22] U.S. Department of Commerce, Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970, Ch. X, Financial Markets and Institutions* (Washington, 1975), 985, 1003; Roland Robinson, *Postwar Market for State and Local Government Securities* (Princeton, 1960), 43; Arthur Levitt, "Problems of School Financing," speech, Dec. 6, 1956, 3, "Education—School Marketing Bonds," folder, box 7, NYS Assistant Secretary to the Governor Subject Files, NYSA (hereafter Asst. Sec. Gov. files).

bond, and Levittown a bid of 2.7 percent for its $1.17 million bond. While the differential might seem marginal, these inequalities compounded 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, the logic of risk assessment punished residents in places deemed uncreditworthy.[23]

Districts experienced rising interest rates as a local problem, but state officials also sought to shield poorer districts for their higher borrowing costs with direct aid payments, shifting some of the responsibility to the comptroller's desk. In 1950, New York's 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 a 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." The makeshift arrangement created a direct stake for the comptroller, as chief fiscal officer, to devise solutions to the problem of rising interest rates in rapidly growing suburban districts.[24]

---

[23] Government Statistical Corporation, *The School Districts of Nassau County, Their Statistics and Finances* (New York, 1950), 13; *Moody's Bond Survey*, 41 (May 16, 1949), 470-71; John Yinger, "Municipal Bond Ratings and Citizens' Rights," *American Law and Economics Review*, 12 (Spring 2010), 1-38.

[24] 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, Muriel and Julian Kane Collection, Stony Brook University Special Collections & University Archives, Stony Brook, NY (hereafter Kane files); Temporary Commission on Educational Finances, *Final Report: Financing Public Education in New York State* (Albany, 1956), 166, 184-186.

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 managed interest rates to slow inflation, undermining the expectations for abundant credit. Rising rates forced policymakers to grapple with the competing promises of postwar liberalism, especially those that relied on market financing. 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 mediate these competing demands. The comptroller's desk sat at the intersection of these vectors, and despite the growing strain on its economic logic, fiscal mutualism remained the active framework for official market action.

New York's patchwork school aid formula, which obliged the state to absorb rising interest costs, reinvigorated the political logic of fiscal mutualism and encouraged Levitt's predecessor, Comptroller J. Raymond McGovern, to invest in local school bonds. Like the temporary school aid, McGovern framed these purchases as an emergency measure. 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. Yet unlike the pension's traditional practice of retail buying, where the comptroller influenced markets by purchasing school securities from bond dealers, in direct bidding the comptroller could set the market 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 informed investment bankers that he intended to bid on the issue at 3.3 percent interest. Given 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.[25]

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, thereby 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—a nearly 400 percent expansion, which increased the pension's holdings of school bonds from 2 percent to 6 percent of the portfolio.[26]

McGovern never publicly discussed these purchases, but observers recognized that direct bidding required a tradeoff between investment returns for retirees and capital costs for school districts. "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." This inherent tradeoff, between secure pensions for state workers and modern schools for suburbanites, was still governed by a view of state finance that sought to balance postwar liberalism's competing promises through mutual investments. But 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.

[25] *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.
[26] "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.

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.[27]

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 were especially resonant in strained suburban districts, 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."[28]

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. He did so, however, 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 brokers could not sell in secondary markets. In March 1955, mere months into his tenure, one

[27] "State Controller Wins School Issue," 36.
[28] 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.

Long Island district prepared an enormous $15.5 million issue, the largest ever floated in the state. The school board urged Levitt to bid directly to prevent an exorbitant interest rate. Levitt declined the request. 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 brokers purchased the issue for 3.1 percent interest, an outcome that reportedly made the school officials "very happy."[29]

Backroom conferences had secured the deal, but the episode also revealed that the comptroller would not attempt to set prices directly. "I avoided fixing the price," Levitt later 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.[30]

Levitt nevertheless remained committed to supporting school construction with state resources. 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. The escalating interest costs for each successive issue, however, became an unavoidable problem. With the economy booming, Federal Reserve officials, worried about inflation, continued to tighten monetary policy. They raised the central bank's discount rate in April 1956, and then again in August, pushing market rates to their

---

[29] "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.
[30] "Regional Marketing of N.Y. School District Bonds Under Study," *The Bond Buyer*, Jan. 12, 1957, p. 4.

highest levels since the 1930s. This policy of "Tight Money," as critics called it, sparked intense political debate, especially among Democrats seeking an election year issue.[31]

Tight Money shocked the school financing 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 certainly not an outlier. In the six months 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 bond markets, the comptroller could subsidize school construction one envelope or 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 underlying structure of school finance.[32]

Levitt became an outspoken opponent of Tight Money, laying out his critiques before Congress's Joint Economic Committee in December 1956. In Levitt's view, the Fed's credit adjustments skewed markets in favor of private, rather than public, borrowers. As interest rates shot up, Levitt implored, local governments bore the extra costs, endangering the basic promises of postwar liberalism. "The quality of education will suffer," he warned the committee. Pointing to the recent 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

[31] *Annual Report of the Comptroller* (1956), 15; *Conflicting Official Views on Monetary Policy: April 1956*, 84 Cong. (1956).
[32] "Average Interest Rates on School District Bond Issues for Upstate New York and Nassau and Suffolk Counties," April 3, 1957, Folder: "Education—School Marketing Bonds," box 7, Asst. Sec. Gov. files; "School Bond Sales, New York State, Oct. 1956-March 1957," in *Federal Aid to States for School Construction*, 85 Cong. 1189 (1957).

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.[33]

While a fierce critic of Tight Money, Levitt hedged on whether public market intervention should be part of the solution. As interest rates kept rising, Levitt began to openly articulate fiscal mutualism's fundamental tension: that the interests of schools and pensioners were antithetical. Levitt assured the public that he remained "prepared to make emergency purchases" of school obligations, 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. There, attendees urged him to increase pension purchases. Levitt 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 afforded by the market."[34]

Public Employee Pensions and the Quasi-Public Welfare State

Levitt's call to secure "the highest rates afforded by the market" reflected ongoing conflicts among state policymakers over the purpose of public pensions. As the school crisis persisted, fiscal mutualism remained politically advantageous, but the economic interests of state

---

[33] "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).
[34] 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.

pensioners and local districts were clearly at odds. Across the country, state fiscal officers chafed under the investment restrictions crafted to encourage fiscal mutualism, while a larger national conversation developed about the place of swelling pension assets in the U.S. financial structure. Moreover, 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 political reputation as a champion of public education, retirement became a second calling, especially as policymakers grappled with how NYSERS should meet—or expand—its promises to pensioners.

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, was not effectively accomplishing either. Eager to extend federal benefits to state workers, state officials began drawing sharp distinctions between federal Social Security and state pensions. In a 1955 report, for instance, 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 instance." He thus shifted the rationale for pensions from adequacy to maximization, a strategy that implied maximizing returns on pension investments.[35]

[35] Hacker, *Divided Welfare State,* 126-129, 138; State of New York, State 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* (1955), 17; "Controller Urges Combined Pensions," *New York Times*, May 16, 1956, p. 37.

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, Levitt's goal of raising retirement benefits dovetailed with his efforts to deregulate NYSERS's investment powers. Here, NYSERS was a relative latecomer. Many states already allowed their pensions systems to invest a portion of their assets in private securities, usually conforming to the legal lists authorized for state-regulated financial institutions, such as insurance companies and savings banks. Where allowed, pension trustees diversified into private securities as the income tax differential drove down municipal bond yields. Other states, like Pennsylvania and New Jersey, responded to low municipal yields by deregulating pension investment powers in the early 1950s. So did New York City, which in 1953 allowed the city comptroller to invest in the same highly-rated corporate bonds as New York savings banks. 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 than their governmental counterparts. 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, one commentator observed, "something like a revolution."[36]

To spark this revolution in New York, Levitt began lobbying for statutory changes that would broaden his investment powers. At Levitt's 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

[36] 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).

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. Governor Harriman, however, vetoed it. The deregulatory law might be unconstitutional, he averred, since the state was constitutionally barred from making loans to private corporations.[37]

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 reflected a growing consensus among state fiscal officers—and the bankers who increasingly advised them—that fiscal mutualism was no longer a viable rubric for pension investment. As Wisconsin's Investment Commissioner explained to a group of state fiscal officers 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 increasingly inclined to agree. [38]

[37] "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.

[38] "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.

The School Financing Authority

Even as Levitt pursued higher returns, he grasped for a durable solution to the school construction crisis. Shortly after the Levittown debacle in November 1956, Governor Harriman appointed a committee 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 alternate methods of school financing, however, its deliberations also became a forum for assessing the merits of fiscal mutualism and the comptroller's fiduciary duty to pensioners.[39]

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 and bundle the issues of individual school districts, then market them together in several large offerings each year. By using economies of scale, the committee predicted, Authority bonds would appear less risky to investors so that, as bond dealer Cushman McGee explained, "the market can be widened." The Authority 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 in bulk; with the public 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

[39] "Ave Moves to Cut Cost of New Schools," *Newsday*, Nov. 28, 1956, p. 7; 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, NYS State Education Department, Commissioner James E. Allen Subject Files, NYSA (hereafter Allen files).

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.[40]

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 comprised solely 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.[41]

Although the committee never addressed fiscal mutualism publicly, behind closed doors the pension purchases of school bonds were the subject of intense deliberation among meeting participants, which included a heavy contingent of financial executives. Of all the topics discussed, the 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

---

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

[41] 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, both Allen files; "Banking Opposition Perils School Bond Plan," *Newsday*, March 19, 1957, p. 7; "School Bond Plan Dies in Committee," *Newsday,* March 30, 1957, p. 1.

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 "underbid the market" since, in doing so, he "depriv[ed] the State employees of their rightful return on their retirement funds." The meetings underscored the comptroller's dilemma. As both local officials and state retirees made claims on NYSERS's funds, the question could no longer be avoided: Whose interest, the schools or the retirees, was the public interest?[42]

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 in secondary markets. Over the next two years, he invested an additional $40 million in school bonds, which, by 1958, 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 directly bidding. "As sole trustee of the Retirement System," he avowed, "I am duty bound to seek the highest return the market affords."[43]

Despite the shifting 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 Democratic Harriman administration. Even as Levitt attempted to extricate himself from his conflicting obligations, he still made lower school interest costs and higher pension benefits central pillars of his reelection bid. Many concluded that his thwarted campaign for the School Bond Authority proved decisive in his surviving the red wave that

[42] Weiss, "Report of Progress as of Jan. 4, 1957," Jan. 7, 1957, 13-14, folder 10, box 47, Allen files.
[43] *Annual Report of the Comptroller* (1959), 15; Arthur Levitt, "Tight Money and Municipal Borrowing," *Municipal Finance*, 30 (Aug. 1957): 18-22, esp. 21.

swept Governor Nelson Rockefeller and a slate of Republicans into office. Like all Democrats in 1958, Levitt lost heavily in the suburbs; he only managed to not lose as badly as Harriman.[44]

Fiduciary Finance and the Logic of Deregulation

Rockefeller's victory backed Levitt into a corner. Levitt 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 continued seeking fiscal support for gubernatorial projects, Levitt renewed his campaign to expand NYSERS's investment powers. In doing so, he embraced the rhetoric of nonpartisan expertise. "When you deal with money and investments, political 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. The language of fiduciary duty 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, a posture that would bring him to the doorstep of Goldman Sachs.[45]

While the fight over the school bond authority grabbed the headlines, Levitt renewed 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 highest-rated bonds of corporations, railroads, and public utilities. Seeking Rockefeller's signature, Levitt

[44] "Arthur Levitt's Victory," *Newsday*, Nov. 7, 1958, p. 41.
[45] John Jay Feeney, "Reminiscences of John Jay Feeney," oral history transcript,1984, Arthur Levitt Oral History Project, Columbia University (accessed at Hamilton University Special Collections, Clinton, NY), 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.

emphasized the plan's fiscal advantages. By broadening the investment options, Levitt argued, the bill 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 legislation merely aligned NYSERS's powers with other 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.[46]

The only direct opposition came from local school officials, who recognized that corporate securities would likely replace school bonds in the NYSERS portfolio. "[T]here were a number of benefits to be derived" from the proposal, conceded the New York State School Boards Association in a missive to Governor Rockefeller. However, the organization 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 crutch of state investment, which had propped up the school bond market for the past decade.[47]

As the school officials predicted, Levitt immediately began pursuing higher market returns. In May 1959, he convened the new Investment Advisory Council at the offices of Goldman Sachs. Sidney J. Weinberg, who led the group, was perhaps midcentury America's most influential financier. Known as "Mr. Wall Street," Weinberg was a potent fundraiser who advised every president from Franklin Roosevelt to Lyndon Johnson. Levitt arrived at the meeting eager to offload low-yielding municipal bonds. The financiers, however, worked to

---

[46] Warren Weaver, Jr., "Levitt Proposes Own List of Bills for Legislature," *New York Times*, Dec. 15, 1958, p. D1; Arthur Levitt to Nelson A. Rockefeller, 7 April 1959, at 14; Arthur Levitt to Roswell B. Perkins, 9 April 1959, at 15, bill jacket, L. 1959, ch. 833, NYSA.
[47] Everett R. Dyer to Nelson Rockefeller, 13 April 1959, at 4, bill jacket, L. 1959, ch. 833, NYSA.

manage his expectations. "Maximum yield should not be the determining factor at all times," the bankers argued. 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 a ten-percent state in school bonds. Given that school bonds still comprised 11 percent the portfolio, the financiers were not advising Levitt to purchase more school bonds. They were simply urging that he take his time orchestrating the sell-off.[48]

The Advisory Council doubtless provided Levitt necessary advice as he moved into corporate securities markets, but the committee also furnished a shield against the Rockefeller administration's calls to maintain fiscal mutualism. Rockefeller entered office with vast infrastructural ambitions, but his building projects would require borrowed funds. When Rockefeller's advisors demanded access to pension investments, Levitt shot back that any loans from NYSERS must 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, like the school districts, would have to pay the going price in the bond market.[49]

In state capitols across the nation, fiscal officials were similarly eager to extricate themselves from the contradictions of fiscal mutualism. As state pensions continued to grow,

[48] Alden Whitman, "Sidney J. Weinberg Dies at 77; 'Mr. Wall Street' of Finance," *New York Times*, July 24, 1969, p. 1; Minutes, Meeting of Comptroller's Investment Advisory Council, May 27, 1959, "Retirement—Investment Adv. Comm." folder, box 3, Levitt Files.
[49] 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, Levitt files.

governors and legislators coveted their investment capital, and state fiscal officers found themselves torn between competing positions: as pension trustees *and* state employees. 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 similar pressures. Although they expressed support for essential infrastructure projects like school construction, in the final analysis the considerations were now 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. But it would be best, the most officers agreed, if lawmakers simply refrained from putting them in this position at all. "I think they would be better off," Szymanski concluded, "if they went into the open market."[50]

The emerging consensus among municipal officers was of little consolation to ambitious state officials who wanted to build cheaply. Rockefeller, for his part, attempted to centralize the investment functions of New York's pensions within his administration. In 1959, he appointed a commission with the ostensible goal of standardizing the investment powers of the state's various pension systems. Recognizing Rockefeller's intentions, Levitt resisted these changes. Instead, he used the pension committee to promote his deregulatory agenda. When the committee's report, completed in December 1959, did not advocate for sufficient liberalization of pension investments, Levitt's staff prepared a blistering response. "The recommendations would…put the public pension systems in a straightjacket," they declared. Commenting on the

[50] John Ottaviano, Jr., "Investment of Trust and Pension Funds," *Report of the Forty-Third Annual Convention of the National Association of State Auditors, Comptrollers, and Treasurers* (1958), 161-167, esp. 163.

draft legislation that authorized just 3 percent of pension assets in common stocks, it continued, "this is reminiscent of the Volstead Act which permitted 3% beer and satisfied nobody."[51]

In its next session, the legislature adopted the recommendations of the revised report, further clearing the path for Levitt to pursue maximum market returns. Additional legislation authorized 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 governing logic 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.[52]

With the 1960 legislation approved, Levitt began remaking the NYSERS portfolio. At the next Investment Advisory Council meeting, the members prepared to rid the retirement system of low-yielding 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

[51] Minutes, Advisory Council Meeting, May 2, 1960, "Retirement—Retirement Adv. Comm." folder, box 3; William M. Girden, "Minority Report: Investment Committee on Pension Funds (Draft)," Dec. 1, 1959, "Kaplan Committee on Pension Funds" folder, box 4, Levitt files.
[52] Letter from Department of Audit and Control, April 7, 1960, at 18, bill jacket, L. 1960, ch. 817, NYSA.

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.[53]

The Permanent Tax Revolt

Just as Levitt began to unwind 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 state aid for debt service, about fourteen cents of every tax dollar went toward paying off past debt obligations—and not to current expenses, like teacher salaries, classroom supplies, or extracurricular activities. Despite the enormous infrastructural investments 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. New schools simply could not be built fast enough. Levittown residents had little control over market fluctuations that added unexpected costs to school construction. They did, however, possess the power to vote "no" on the budget.[54]

---

[53] Minutes, Advisory Council Meeting, May 6, 1960, "Retirement—Investment Adv. Comm." folder, box 3, Levitt files.Minutes, Meeting of Comptroller's Investment Advisory Council, May 6, 1960, "RETIREMENT—Investment Adv. Comm." folder, box 3, Levitt files.

[54] "12 LI School Districts Kill Budgets," *Newsday*, May 7, 1959, p. 3; State Education Department, Division of Research, *School District Voting in 1958-1959 School Year, Bond and Budget Referendums* (Albany, 1959), 13; 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: 1952/1962), 49, 52; New York University, *Levittown's Schools and the Future of the Community: A Survey by the Center for*

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

The school tax revolt is best understood as a revolt against the financialization of school construction—as the failure of the state to effectively 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. In the middle, the flyer depicted an exasperated taxpayer with

---

Community and Field Services (New York, 1954), 264, 445; District 5 Board of Education, "Fact Sheet on the Site Proposition to be Voted Upon May 6, 1958," folder 3, box 2, Kane files.

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, the popular discontent with financialization. Though the candidates put forward no alternatives for how schools might be financed, they did offer weary taxpayers a direct outlet for their rage. A vote for them, and against the budget, would supposedly "Stop Wasteful Spending of *Your* Money!"[55]

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 financial markets. Local officials could now consult professional investment bankers when preparing bond prospectuses and planning the timing of bond 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 the fluctuations in capital markets. Wherever the bond market moved, so moved the definition of "excessive."[56]

Together, the emergency construction aid, the excess interest payments, and the demise of the School Bond Authority amounted to the surrender of public intermediation to the bond market. The shift was subtle, though ultimately consequential. Under fiscal mutualism, the state

---

[55] Frank Johnson, "Say Tax Revolt Shows Need for School Study," *Newsday*, May 8, 1959, p. 7; Information and Education Committee, "VOTE, May 6th," flyer, folder 2, box 4, Kane files.
[56] "Levitt to Counsel Schools on Bonds," *New York Times,* May 14, 1959, p. 50; 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, Subject Files Concerning State Financial Aid for Education, NYSA.

held a direct stake in public infrastructure. Officials used the market power of state investments to shape the bond market. Although operating on a different logic, the School Bond Authority had aimed to restructure the existing power relations by enhancing the position of districts with weak credit ratings. The compensatory aid payments, by contrast, followed a different path. Rather than attempting to shape 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 that were beyond their control. The comptroller could react, but he was no longer an actor.

The Promise of Financial Liberalism

Abandoning fiscal mutualism reconfigured the relationships between school districts, the state, and financial markets. At the same time, increasing investment returns allowed for a reimagining of the benefits that pensions could offer state employees. Levitt continued to pursue, as he put it in his 1960 *Annual Report*, "maximum yield for the Fund." In practice, this meant selling the school bonds and other municipal bond holdings, and reinvesting the assets in private mortgages and corporate securities. In the midst of this transition, Levitt began campaigning to make NYSERS a 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 promises of postwar liberalism through the power of financialization.[57]

The financial logic driving municipal disinvestment quickly became self-reinforcing. As Levitt steadily offloaded municipal bonds, NYSERS aggregate yields continued to rise, from

[57] *Annual Report of the Comptroller* (1960), 38.

3.35 percent in 1959 to 4.33 percent in 1965. As a result of the increased yields, by 1962 the state no longer had to make deficiency payments. Many observers attributed this change 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 justified 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."[58]

Even while discarding fiscal mutualism, Levitt hinted that the pension system might still intervene in municipal bond markets. "We don't intend to get rid of all our municipals," Levitt told the *Wall Street Journal* in 1962. In practice, however, the sell-off was almost complete. In 1958, NYSERS held more than $350 million in municipal securities; by 1966, it held just $40 million, cemented in the high-risk school bonds that Levitt had purchased to prop up the market over the previous decade. In the short run, the threat of fiscal intervention proved unnecessary. During the 1960s, commercial banks surpassed wealthy individuals as the dominant market for municipal bonds. While interest rates never returned to their postwar lows, the entrance of this new source of capital helped hold down municipal borrowing costs during the 1960s.[59]

---

[58] *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; Arthur Levitt to Sol Neil Corbin, 19 March 1964, at 14, bill jacket, L. 1964, ch. 369, NYSA.

[59] "New York Employees Fund Sells $16,754,000 Of Outstanding Bonds," 15; Martin Arnold, "Battle Waged in Albany to Control Pension Funds," *New York Times*, March 14, 1966, p. 1; William Crowder 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 (Sep. 1999), 107.

With NYSERS yields consistently 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, on the back of promises to state retirees, his advisors urged him to make the non-contributory pension his "No. 1 proposal." Although the policy took time to implement, by 1966 NYSERS had become a fully non-contributory system. No longer would state workers need to fund their retirement. Instead, the market would guarantee their future economic security.[60]

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 public securities, subsidizing civic projects in the process. Balancing the interests of state retirees and governmental borrowers, comptrollers helped build public infrastructure with pension money. Fiscal mutualism, in sum, satisfied a range of constituencies while prioritizing stable investment over maximum returns. Yet with mutualist regulations stripped away, conflict shifted from who should make retirement contributions to who should reap the gains from the market. New collective bargaining rules and stronger public unions only increased the incentives for employers and employees to resolve

[60] "Pension Gain Sought," *New York Times*, Sep. 2, 1960, p. 6; 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, Levitt files; "Battle Waged in Albany to Control Pension Funds," 1.

present disputes by making promises about the future. With the reconstitution of NYSERS as a contribution-free system, markets were expected to deliver on those promises.

The transition to market dependence 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 higher than ever before, from a nationwide average of 3.67 percent in 1965 to 6.39 percent in 1969. The state, however, was no longer an agent in bond markets; borrowing districts had to pay whatever price the market commanded. State officials felt powerless. "[T]here is not very much we can do to lower interest costs," a Rockefeller aide complained in an internal memo. To help districts meet the rising interest costs—as well as rising salaries and operating expenses—lawmakers increased state aid to local school districts, which by 1970 accounted for 35 percent of the state budget. But the state's support of local schooling did not extinguish the tax revolts; it escalated them. Instead of venting their fury at amorphous market forces, overstretched taxpayers directed their rage at the state itself. Throughout the 1970s, about one-fifth of school districts rejected their budgets every spring, in what became an annual plea for greater state aid. "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."[61]

Exasperated by the education system's dependence on markets, Levitt nevertheless enhanced the pension's stature as a market participant. Over the 1960s, as lawmakers continued deregulating his investment powers, Levitt placed an ever-larger share of NYSERS assets in corporate stocks. He also worked to change the basic structure of securities markets. In 1971, in

---

[61] U.S. Department of Health, Education, and Welfare, *School Bond Sales for Public Purposes: 1969-1970* (Washington, 1969), 11; Lewis Bart Stone to Robert R. Douglass, Memo: "State Bonding Authority for School District Bonds," 2, Oct. 2, 1969, folder 162, box 15, Robert R. Douglass Files, Series 10, Rockefeller Archive Center, Tarrytown, NY; Report of the New York State Commission on the Quality, Cost and Financing of Elementary and Secondary Education (Albany, 1972), 2D.2, 2.65-2.67; New York Department of Audit and Control, *Financial Data for School Districts* (Albany, 1971), v.

a bid to circumvent brokerage firms and execute securities trades himself, he sought a seat on the New York Stock Exchange—a move that helped precipitate the deregulation of brokerage commissions nationwide. Levitt's actions were brazen but not exceptional; across the country, public pension managers sought to maximize returns by expanding their direct market participation. In the end, markets have largely delivered for New York pensioners, though not always for retirees in other systems. NYSERS has so far avoided the chronic underfunding and high-risk investments that have led many other public pensions into crisis.[62]

As the chief fiscal officer of the state's schools, Levitt became the object of financial markets; as the trustee of the state pension, he became an empowered financial subject. The comptroller's dual roles, once consonant under fiscal mutualism, diverged onto separate paths. This divergence was a long-term process, the culmination of choices made during the prosperous 1950s, and not simply a reaction to the crises of the 1970s. 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.[63]

---

[62] 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; Alicia Haydock Munnell, *State and Local Pensions: What Now?* (Washington, 2012).
[63] For a similar argument about long-term processes, see the editors' introduction in *Shaped by the State: Toward a New Political History of the Twentieth Century*, eds. Brent Cebul, Lily Geismer, and Mason B. Williams (Chicago, 2019), 1-23.