EBRI NOTES

EMPLOYEE BENEFIT RESEARCH INSTITUTE • 1920 N Street, NW/Suite 520/Washington, DC 20036 • (202) 659-0670

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EBRI HOLDS FORUM ON THE TAX TREATMENT OF EMPLOYEE BENEFITS

In recent years, there have been significant changes in federal tax laws affecting employer-sponsored benefit programs and individual retirement savings programs. The 1981 Economic Recovery Tax Act (ERTA) expanded the availability of individual retirement accounts (IRAs). The 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) cut back the maximum tax deductible contribution and benefit limits on defined contribution and defined benefit plans. A number of new legislative proposals are now pending in Congress--e.g., President Reagan's health care reform package, the Retirement Equity Act, the Economic Equity Act and the Private Pension Reform Act.1/ To examine the rationale for present tax policy and the implications of proposed changes, EBRI sponsored a June 8 policy forum entitled "The Tax Treatment of Employee Benefits: Yesterday, Today and Tomorrow."

The tax treatment of employee benefit programs has come under close examination. This is largely a result of unprecedented budget deficits and a need to raise federal revenue. Many of EBRI's forum participants stated that current benefit program tax provisions are desirable, because they result in retirement income security and health protection for large numbers of workers. Tax policy changes could result in reduced levels of such protection.

Everett Allen, Jr., Wharton School Professor and Towers, Perrin, Forster & Crosby, Inc. Vice-President, stated "national policy...should nurture and support the private employee benefit industry. They [employee benefit programs] provide a network of economic security...in the event of

1/ For more details on the specifics of these proposals, see EBRI Notes, "The 'Tax Equity' Movement: Implications for Employee Benefit Programs," vol. 4, no. 1 (January/February 1983), p. 1; EBRI Notes, "Women's Equity Proposals Gaining Attention," vol. 4, no. 2 (March/April 1983), p. 5; and Issue Brief, "Retirement Program Tax Expenditures: A Case of Unsubstantiated, Undocumented, Arbitrary Numbers," no. 17 (April 1983).

retirement...death or illness. They also are of material value in the capital formation area." Allen noted that one important result of recent policy changes is the increased emphasis on defined contribution plans. He said that TEFRA's top-heavy rules and pension plan contribution and benefit limits may also discourage defined benefit plan growth. This may result in future problems, since many experts believe defined benefit plans offer greater inflation and investment risk protection than is offered by defined contribution plans.

Harry Smith, Sun Company, Inc., Human Resources Special Projects Director, also expressed concern over legislation that might discourage employer pension plan development. He noted that it is "psychologically unsound to assume that human beings, if left to their own devices, would really provide themselves with logical, sound, cost-effective, integrated benefits."

Other forum participants argued that the present tax incentives have not always been well designed. In some cases, they may not serve the majority of employees. Furthermore, the favorable tax treatment of certain benefits may be inappropriate. For example, Mike Melton, Boston University Law School Professor, expressed concern that IRA utilization is much higher among people at higher-income levels.2/

Daniel Halperin, Georgetown University Law Center Professor, also believes that tax incentives, particularly those for flexible compensation plans, are not necessarily "well designed to promote the type of spending...or the type of savings we are interested in for the low- and moderate-income people [e.g., purchasing health or retirement protection]. Low-income workers may not respond to such tax incentives. The only thing that will get us some kind of a broad base of participation is employer intervention." Halperin felt there was merit in the flexible compensation approach, however, he noted "The real question...is whether it can work as well in practice as...suggested in theory."

Participants also discussed President Reagan's health care reform package. Among Reagan's proposals is a plan to limit the amount of tax-free, employer-provided health benefits. According to Paul Ginsburg, Deputy Assistant Director for Income Security and Health, Congressional Budget Office (CBO), there is a 38 percent tax subsidy (average marginal tax rate of 25 percent, plus combined employee and employer Social Security contribution rate of 13.4 percent) that results when compensation is in the form of health benefits rather than cash wages. Thus, employees and employers receive more compensation dollars when they are provided in tax-free health benefits. A number of experts believe this practice, which results in third-party health care payments, has led to higher medical care costs.

2/ Note that EBRI data indicate: (1) among families with annual incomes below $20,000, about 5 percent participate in IRAs; (2) among families with incomes between $20,000 and $50,000, 26 percent participate in IRAs; and (3) among families with annual incomes above $50,000, 55 percent participate in IRAs.

Ginsburg has calculated estimates of reductions in health care spending that could result from the President's proposal. He estimates "that after about five years with a cap at this level, those who are receiving employer-paid health insurance would reduce health spending by about 9 percent." Critics of the tax-cap proposal argued that insurance coverage of hospital care--the most rapidly inflating element of health care services--would not diminish in response to a cap. Utilization of hospital services, therefore, would not decline, and might even rise if the use of substitute services (e.g., hospital outpatient care, office surgery by physician) became uninsured.

Estimates of federal revenue gains from the tax-cap legislation also were discussed. Some forum participants questioned CBO's predictions for large revenue savings--more than $2 billion in 1984. CBO's calculations assume that reductions in employer-health insurance contributions will result in higher taxable wages paid to the employee. These projections could be high, since taxation of health benefits may merely result in a shifting of tax-free compensation from medical benefits to other types of tax-free, employer-sponsored benefits.

A number of participants also expressed serious concern over inequities that could result from the tax-cap proposal due to geographical variations in medical insurance costs. The same health insurance policy may cost more in Chicago, for instance, than Little Rock. A Chicago worker may receive the same "level" of health coverage as a Little Rock worker, however, the Chicago worker may pay taxes while the Little Rock worker may not.

Dallas Salisbury, EBRI's Executive Director, concluded that "all too frequently we segment little pieces of legislation thinking that we can change the entire realm of employee benefits." Salisbury commented that even though the law is changed, behavior will not necessarily change in the desired manner. People will find other options. "We need to look at employer programs in their entirety, along with Medicare, Medicaid, Social Security and other social programs, to evaluate whether the system is effective as a whole."

CATO INSTITUTE/SOCIAL SECURITY CONFERENCE

The CATO Institute held a conference on June 6-7 in Washington, D.C. The topic of the conference was "Social Security: Continuing Crisis or Real Reform." Conference participants included government analysts, academics and private sector representatives who offered an analysis of whether further reform is needed and, if so, suggestions for such reform. Many participants felt that past legislative changes aimed at resolving Social Security's problems have been short-term solutions, and such "patchwork" changes do not assure the payment of promised benefits to all workers.

For example, A. Haeworth Robertson, former Social Security Administration Chief Actuary, noted: "The system has financial problems that are relatively small for the next ten years or so, but they will become enormous after the turn of the century. To restore the balance in income and outgo solely by tax increases would require the current employee [and employer] tax rate of 6.7 percent to increase relentlessly for the next fifty years to a level of 14 percent to 20 percent."

Representative William Archer (R-TX) noted that politics dictate all attempts to reform the system. He stressed that Congress should consider a full range of realistic options rather than an intermediate approach. Archer noted that no matter how many times the Social Security system faces a crisis, the American public is continually reassured that the system will be saved. Inevitably, however, another crisis develops.

Panelist Norman Ture, Institute for Research on the Economics of Taxation, echoed Archer's viewpoint, stating: "Why should the world's largest insurance program have to go through these fixes so often? What never seems to come through loud and clear is that the system is fundamentally flawed."

Peter Peterson, Chairman of the Board, Lehman Brothers Kuhn Loeb, predicted that the system's unresolved problems "will raise moral, political, ethical and social issues of the worst kind." To resolve these problems, "we will need another Social Security Commission in the mid-to-late 1980s." Peterson noted that as a nation, we are investing three-to-four times more in the elderly than we are investing in the younger population. This raises a fairness issue as well as a concern about our nation's future productivity. Peterson stressed, however, "within the context of any reform, we must reaffirm our commitment to the poor."

A number of speakers discussed the possibility for legislation that would permit individuals to opt out of Social Security. However, some did not believe this was politically feasible, because many younger workers: (1) sense a welfare obligation to the elderly; and (2) believe if they opted out, they would pay for existing claims during a phase-out period without ever receiving benefits themselves.

Carolyn Weaver, Staff Member of the Senate Finance Committee, also agreed that recent legislation did not cure all of Social Security's problems. Weaver, however, expressed cautious optimism that "real reform" of the Social Security system will be possible in coming years because:

- people will become more disenchanted with the system as rates of return on Social Security contributions decline;

- the population, especially the young-worker group, is uncertain whether it will receive promised benefits.

For real reform to take place, Weaver believes we need:

- a clear and articulate alternative, which relies on tried and true practices; e.g., a modified version of the IRA;

- an active administration, which supports such a proposal and develops a strategy for convincing "a sufficient number of voters that they will benefit from the proposal."

A number of speakers and participants stated that radical reform is not needed. For example, Joseph Pechman, Brookings Institution, expressed overall satisfaction with the present system. Pechman focused on the positive aspects of the program and pointed out that it: (1) has given dignity to millions of Americans; and (2) has raised the level of income for many disabled, widowed and elderly persons.

The proceedings of this conference will be published in the fall issue of the CATO Journal. For more information, contact: Publications Department, CATO Institute, 224 2nd Street, SE, Washington, DC 20003, (202) 546-0200. Price-$5.00.

MAJOR GROWTH IN IRAS REPORTED

In the first four months of 1983, Americans deposited $20.5 billion in individual retirement accounts (IRAs) based on data compiled by EBRI. Assuming that all IRA deposits after January 1982 (including the January-April 1983 deposits) were made for the 1982 tax year, IRA savings deducted on tax returns totalled $54.3 billion. If the enthusiasm for IRAs continues, IRA assets could exceed $135 billion by the time 1983 tax returns are filed. As shown in table 1, this compares to $25.7 billion in IRA assets at the end of 1981--an amount that had accumulated over 1975 to 1981.

Commercial banks and thrift and depository institutions hold the major portion of these assets. They have held approximately 75 percent of total IRA assets since 1981. Mutual fund deposits doubled over their April 1982 level, but they continue to account for a roughly constant 12 percent market share. Life insurance companies continue to hold an edge over mutual funds--life insurance deposits totalled $10.3 billion while mutual funds totalled $9.3 billion.

TABLE 1

Assets in Individual Retirement Accounts--1981 to 1983

Financial Institution	Year-end 1981 (billions)	April 30 1982 (billions)	Year-end 1982 (billions)	April 27 1983 (billions)
Commercial Banks 1/	$ 7.0	$12.6	$17.9	$26.3
Thrift Institutions 1/	12.6	22.5	27.7	33.6
Mutual Funds				
Money Market 1/	1.5	3.4	4.6	5.3
Equity	1.1	1.5	2.8	4.0 2/
Credit Unions	0.2	0.5	NA 3/	NA 3/
Life Insurance	3.3	NA 3/	6.0 4/	10.3 5/
Total Holdings 6/	$25.7	$43.8	$59.5	$80.0

Sources: EBRI tabulations of data provided by Federal Reserve Board, National Credit Union Administration, Investment Company Institute and American Council of Life Insurance.

1/ IRA and Keogh accounts.
2/ March 1983 data.
3/ Not available.
4/ September 1982 data.
5/ March 1983 preliminary data.
6/ Totals computed using latest available data for each sector.

OTHER EBRI ACTIVITIES

EBRI staff members have given a number of presentations at major conferences and published a number of papers:

- Participant, conference on Social Security, Center for Economic Policy Research, Stanford University, May 5-7.

- Speaker on "Implications of TEFRA and the Potential Effects of the 1983 Fair Tax Act," International Foundation of Employee Benefit Plans, Legislative Update Conference, Washington, D.C., May 10.

- Discussion Leader, "Meet the Regulators" workshop, International Foundation of Employee Benefit Plans, Legislative Update Conference, Washington, D.C., May 10.

- Keynote Speaker on "Employee Benefits for the 80s and Beyond," Employee Benefits Planning Association, Seattle, Washington, May 11-15.

- Speaker on "The Implications of the 1983 Social Security Amendments for Employer-Sponsored Retirement and Deferred Compensation Programs," American Bar Association's Tax Section meetings, May 21.

- Speaker on "Tax Policy and National Retirement Goals," Association of Private Pension and Welfare Plan's annual meeting, Washington, D.C., May 25.

- Presented a paper on "Pension Policy and the Corporation," Brookings Institution seminar for corporate executives, May 26. The presentation focused on the financial implications of recent pension policy changes and pending congressional proposals.

- An EBRI paper "The Cost and Funding Implications of Modifying the Civil Service Retirement System," was included in a Senate Committee on Governmental Affairs committee print, "Civil Service Pension Reform Act." The paper details the cost of the current Civil Service Retirement System and an alternative plan to coordinate coverage of new federal workers with Social Security. It examines the overall impact of modifying the federal retirement program on the unified budget and on internal funding transactions. Reference #P-8, 25 pages, $2.50.*

- The Western Economic Association International published EBRI's paper on "Providing Income Security to the Elderly: The Role of Programs Other than Social Security," in Contemporary Policy Issues, April 1983. The paper discusses the relative roles of various retirement income sources; e.g., employer pension programs, individual savings and asset income, employment earnings and welfare programs.

* Copies of EBRI's papers and testimony are available by contacting: Jean Smith, EBRI-ERF Publications, 2121 K Street, NW, Suite 860, Washington, DC 20037, (202) 659-0670.

EBRI has actively provided information to the Executive Branch and the Congress. For example, the following testimony was presented at governmental hearings in June:*

- United States Senate Committee on Finance, "Pension Rights for Women," June 20, 1983, Reference #T-15, 48 pages, $5.00.

- Department of Labor ERISA Advisory Council, "Social Investment of Pension Plan Assets," June 14, 1983, Reference #T-16, 6 pages, $1.00.

- United States House of Representatives, Special Committee on Aging, "Women's Pension Equity," June 14, 1983, Reference #T-17, 29 pages, $3.00.

- United States Senate Committee on Finance, "Tax Treatment of Employee Benefits," June 22, 1983, Reference #T-18, 36 pages, $3.50.

- United States Senate Committee on Finance, "Tax Expenditures," June 29, 1983, Reference #T-19, 29 pages, $3.00.

OTHER OUTSIDE ACTIVITIES

Employee Benefits Handbook, Fred K. Foulkes, ed.

This handbook offers "a comprehensive analysis...of traditional and innovative benefits packages." Traditional benefits, such as health and disability protection, are compared to newer benefit options, such as group legal services and flexible compensation plans. The advantages and disadvantages of the various benefit plans are examined. In addition, the Employee Benefits Handbook considers important aspects of plan administration and government regulation. For more information, contact: Gerald Sniegocki, Warren, Gorham & Lamont, Inc., 210 South Street, Boston, MA 02111, (617) 423-2020. Price-$57.50.

Market Reforms in Health Care, Jack A. Meyer, ed.

This book examines a market reform approach to health care cost containment. This approach utilizes incentives to change consumer and provider behavior. The need for fair choices among alternative health plans is stressed. The objectives of such an approach are to eliminate unnecessary care and inefficient services. Problems associated with the market reform approach are considered and alternative methods for overcoming these problems are assessed. For more information, contact: American Enterprise Institute for Public Policy Research, 1150 17th Street, NW, Washington, DC 20036, (202) 862-5800. Price-paperbound $10.95, clothbound $19.95.

* Copies of EBRI's papers and testimony are available by contacting: Jean Smith, EBRI-ERF Publications, 2121 K Street, NW, Suite 860, Washington, DC 20037, (202) 659-0670.

Public Policy and the Aging, William W. Lammers

In 1940, 6.8 percent of the United States population was age sixty-five or older. According to the 1980 Census, this percentage has risen to 11.3 percent. In 2020, the percentage of the population which is over age sixty-five is projected to be 15.5. This book explains the rapid expansion of the elderly population. It discusses the effect of this expansion on the development of United States programs, e.g., retirement, health care, housing and social service. The book also examines various policy questions including: (1) How can the nation's health care system be reformed to reduce the number of elderly needlessly kept in nursing homes? (2) What changes can be expected in the labor force participation of persons over age sixty-five? (3) Are aging-based interest groups effective on Capitol Hill? For more information, contact: Congressional Quarterly Inc., 1414 22nd Street, NW, 3rd Floor, Washington, DC 20037, (202) 887-8500. Price-$7.95.

The IRA Book: The Complete Guide to IRAs and Retirement Planning, Robert Krughoff and the staff of the Center for the Study of Services

The IRA Book contains information on hundreds of banks, savings and loans, money market funds, mutual funds, brokers and insurance companies. The book is intended to help consumers determine the best way to incorporate IRAs into their retirement planning. It discusses methods for moving IRA assets from one institution to another while maintaining a high return. Also included are suggestions for alternative retirement tax shelters and tips on managing income and assets after retirement. For more information, contact: Center for the Study of Services, 1518 K Street, NW, Suite 406, Washington, DC 20005, (202) 347-9612. Price-$5.95.

Adjusting Pensions for Inflation: Is the "Excess Interest" Method the Answer?, Geoffrey N. Calvert

This eighteen-page pamphlet discusses a proposal in the Canadian government's "Federal Green Paper on Pension Reform." The proposal recommends that pension benefits should be adjusted for inflation by using an "excess interest" method. Some feel that this proposal is "dangerous to the successful operation of Canadian pension funds."

The excess interest method was developed in response to criticisms of the private pension movement in Canada. Calvert explains this method and provides arguments to support his conclusion that the "whole excess interest idea...should now be given a decent burial." The pamphlet concludes with a list of alternative approaches for Canadian pension reform. For more information, or to obtain a free copy, contact: Housser & Co. Limited, Suite 1200, 60 Yonge Street, Toronto, Ontario, M5E 1S1, (416) 364-0264.

Preretirement Planning...It Makes a Difference, National Audio Visual Center

A fifteen-minute Social Security film, which describes how three couples and a widow prepared for retirement, is publicly available. It is available in 16 mm film, 3/4 inch videocassette, and 1/2 inch Beta or VHS videotape. For prices and other information, contact: National Audio Visual Center, National Archives and Records Service, General Services Administration, Washington, DC 20409, (301) 763-1896.

N O T I C E

On July 13, the Employee Benefit Research Institute is moving to:
2121 K Street, NW, Suite 860, Washington, DC 20037

The phone numbers will remain the same:

Executive Director:	(202) 463-8154	Education/Communications:	(202) 659-0670
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The Employee Benefit Research Institute (EBRI) was established in 1978 to contribute to the development of public policy in the employee benefit field. EBRI, a nonprofit organization, has a broad membership that includes private sector companies and individuals with interests in employee benefit education, research and public policy.

EBRI also has a separate Education and Research Fund (ERF) which is operated exclusively to conduct charitable educational and research activities. The Fund is tax exempt under section 501(c) (3) of the Internal Revenue Code and is not a private foundation. EBRI Associates make contributions or grants to the Fund which are deductible as charitable contributions.

EBRI's policy forums, research studies, issue briefs, pamphlets and other publications aid public and private sector decision makers, managers, the press and the general public in formulating and articulating positions on employee benefit issues. As health and retirement issues receive increasing attention, the Institute strives to make effective and responsible contributions to public policy.

RETURN TO: EBRI, 1920 N Street, NW/Suite 520/Washington, DC 20036 (202) 659-0670

EBRI NOTES, a bimonthly newsletter, includes information about: 1) newly released employee benefit statistics; 2) brief summaries of EBRI's ongoing research studies and forum discussions; and 3) reviews of outside research and publications.

ISSUE BRIEFS, published monthly, offer summary information and critical analysis of evolving employee benefit issues and trends.

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