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STATEMENT OF

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The Future of Retirement Savings in America

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Introduction

I am Dallas L. Salisbury, Executive Director of the Employee Benefit Research Institute (EBRI). I want to thank you for giving us this opportunity to appear. EBRI was established in 1978 to meet the growing need for professional analysis and comprehensive, practical, objective research on employee benefits. In keeping with our role as a non-lobbying educational and research organization, I will today review information on the potential scope of retirement savings in the future and potential implications of pending proposals.

Retirement Savings Without Policy Change

Through social security, individual efforts, and employer sponsored programs, retirement income security is sought. To meet the objective of that security there must be a careful balance between benefits and costs, and concentration on the avoidance of mis-allocating scarce dollars.

The "PREPARE" package of proposals authored by Chairman Pepper presents a broad range of changes intended to strengthen all of the noted components of the system.

PREPARE maintains the minimum participation standard established by ERISA in 1974. The protection provided by employer sponsored plans, and the expansion that might occur with PREPARE, are both important.

- Of this non-agricultural ERISA population (25-1-1000) 74% work for employers sponsoring plans, 68.3% participate, and 55.7% are vested.
- While the participation rate grew by 23% between 1950-1979, participation in absolute numbers grew by 263%.
- Of those who have been with their current employer for more than 5 years, 66% are vested; for more than 10 years, 78% are vested. With time these numbers will move towards 80% and 100% respectively. They will grow as news plans are formed.
- Of those now participating in a plan 9.2% hold vested rights in another plan from previous employment.
- Of those not now covered by an employer plan 14.3% hold vested rights from previous employment.
- Pension plan growth was dramatic prior to ERISA, but following passage net new plan creations dropped from 54,601 in 1974 to 3,494 in 1976. The initial negative response to ERISA appears to have been overcome, however, with 56,063 net new plans created in 1980.

Based upon both short and long terms trends employer sponsored coverage, participation and vesting <u>can be</u> expected to increase substantially in the future.

Employer sponsored plans had generated $653 billion in accumulated assets by the end of 1980. Private funds grew at a 12.4% annual rate between 1950-1979; public funds at an 11.1% annual rate. The net inflow of funds in 1980 exceeded $16 billion and as present plans mature and new plans are formed this amount can be expected to grow.

Dependent on whether one accepts research indicating a positive net savings contribution resulting from employer plan contributions of 35% or 80% per dollar, 1980 contributions represent a net addition to savings of between $5.6 and $12.8 billion dollars.

Individuals also make a substantial direct contribution to retirement savings. Through IRA's and thrift-savings plans additional billions of dollars have been set aside. Present trends indicate that the IRA is increasingly being used and that the thrift-savings plan is becoming extremely popular. Research indicates that the utilization of thrift-savings plans is relatively constant across income groups, including very low earners. This is attributed to the fact that all employees receive the same degree of employer matching. In the future, the role of such vehicles will continue to grow. While this is desirable, its impact on employer sponsored plans deserves more study. There is evidence that IRA's cause a reduction in participation if that option exists.

Retirement Savings and Proposed Legislative Changes

PREPARE includes a number of proposals which could increase the cost of the social security program. When evaluating these changes the effect on other retirement programs should be explored, since social security has a substantial impact on total compensation and may adversely affect savings, and employer sponsored pension plans.

- From 1950 to 1980 the tax cost of social security went from 3% of the first $3,000 in earnings ($6,000 in 1967 dollars), to 12.26% of the first $25,900 in earnings (10,335 in 1967 dollars).

These increases serve to (1) reduce employee dollars available for voluntary savings and (2) reduce employer dollars available for providing employee benefits or cash compensation. Additional increases are already in the law, and increasing benefits would require additional revenues. Since research indicates that at best social security does not increase savings (and may decrease savings), while individual and pension contributions do increase savings, the impact of policy changes could be significant.

- PREPARE would expand IRA eligibility to those covered by employer sponsored plans: the effect of this change could be substantial.
  - IRA's would become available to at least 8.7 million workers who are presently covered by an employer sponsored plan but do not participate.
  - IRA's would become available to at least 43.5 million workers who presently participate in an employer sponsored plan.

oo Were one to assume that utilization by income group was the same as at present, and that only non-agricultural private sector workers ages 25-64 with one year of service and working more than half time were to open IRA's, 2.63 million IRA's would come into existence. Assuming an average contribution of only $750 per IRA would produce $1.97 billion in total annual contributions. Inclusion of public sector workers could add several hundred thousand additional IRA's.

As previously noted, however, there is evidence that some of this expansion would be at the expense of existing plans and could mitigate new employer plan formation.

PREPARE suggests a number of changes to encourage individual initiative in saving for retirement and employer incentives for plan creation. The interrelationships of these changes, with other provisions of PREPARE should be carefully explored. In addition there are implications for total government revenue and expenditures to be understood. Without making a judgement on appropriateness certain observations on PREPARE are possible.

o Tax credits for employers: Since present trends indicate that new plan formation is occurring and can be expected to occur in the future, tax credits should increase plan creation rates. It should be understood, however, that several hundred thousand businesses report no profits in early years of growth. For such firms a non-refundable tax credit would not have an incentive effect.

- o Refundable tax credits for individuals: available evidence indicates that such a provision could increase individual initiative, particularly for lower income individuals. Recent surveys indicate that nearly 75% of workers would take advantage of such a savings opportunity.
- o Increased contribution limits: available evidence indicates that such changes could be expected to have an immediate effect for those with IRA's today, particularly if the 15% test is eliminated.
- o Five year vesting: PREPARE suggests a change in cliff vesting from 10 years to 5 years. Such a change could be expected to increase vesting for those with 5 or more years of service from the present level of 66% to approximately 80%. The change would increase total benefit payments, but for those leaving at just over 5 years values would be low. The effect on retirement savings would depend upon whether the costs of faster vesting were met by long term contribution increases <u>or</u> benefit reductions.
- o Minimum private benefits: PREPARE would provide a minimum private benefit to all <u>participants</u>, or the 49.7 million workers who would meet the ERISA participation standards if their employer had a plan. This acceptance of the ERISA standard recognizes the ten years of study that led Congress to exclude very young and mobile workers from mandatory participation in employer sponsored plans.

PREPARE would require minimum benefits, therefore, for 14 million workers not now participating in a plan but meeting the ERISA standard, and about 34 million participants. The distribution of non-participants is important to an assessment of cost-impact and the location of future retirement savings:

- approximately 67% work for employers with fewer than 100 employees;
- approximately 48% work for employers with fewer than 25 employees;
- approximately 68% have annual incomes below 15,000 dollars per year;
- approximately 58% have been with their current employer less than 6 years.

PREPARE would create new costs for employers who do not now have plans partially offset by tax credits.

PREPARE would increase plan costs for almost all existing defined benefit plans -- approximately 30 million of 34 million participants -- due to the nature of present funding practices. This would occur since the 4% contribution rate would generally exceed today's contributions for employees below age 50 in defined benefit plans.

The effect of such a minimum benefit proposal on existing plans would have to be carefully assessed: ERISA experience indicates that termination of many defined benefit plans might result. The adverse effect on the present high rate of new plan creations could also be significant. And, the effect on the development of other employee benefit programs, employment levels, firm bankruptcies and formations, and other issues should be explored. Regrettably, we have no such research to point the Committee towards.

Conclusion

Retirement savings is highly desirable. Additional retirement savings is necessary if America's elderly are to maintain pre-retirement standards of living. While it is possible that this goal cannot be achieved, progress can be made. The interrelationships and complexity of our retirement savings programs, other private and public programs and the economy in general must be carefully explored, however, if we are to avoid unintended disruptions. EBRI hopes that its comprehensive research program will be able to increase understanding of these proposals and thus lead to more effective decisions.

Thank you for giving us this opportunity to appear. I would be pleased to respond to any questions.