A Statement on

Tax Incentives For Pensions and Flexible Compensation Plans

For Inclusion in the Written Record of the

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Committee on Ways and Means

Hearing on the Taxation of Employee Benefits

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by
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The views expressed in this statement are solely those of the author and should not be attributed to the Employee Benefit Research Institute, its officers, trustees, sponsors or other staff.

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Mr. Chairman, I am pleased to submit this statement on tax policy issues in pensions and flexible benefits programs. Tax provisions governing pensions and flexible compensation plans have figured prominently in Congressional debates over the last three tax bills. In my statement today, I will address the following questions:

o What is the revenue cost of pensions and flexible benefits plans?

o Who receives these tax benefits?

o What does society get for the foregone revenue?

o Are tax incentives more effective or less effective in achieving certain goals than other policy devices aimed at the same goals?

o What are the implications for upcoming policy debates?

Trends in Employee Benefits

Employer contributions for employee benefits have increased steadily as a share of compensation over the last thirty years. According to Department of Commerce estimates, cash outlays for employee benefits beyond wages and salaries have grown from 4.9 percent of total compensation in 1950 to 15.8 percent in 1982. Over a third of this amount finances employer-sponsored pension plans. Pension contributions increased from 1.8 percent of employee compensation in 1950 to 5.3 percent in 1982. This growth appears to be slowing, however. Between 1980 and 1982, for example, employee benefits grew 1.6 percent annually as a share of compensation, compared with an annual rate of over 4 percent between 1970 and 1980.

The tax-favored treatment of qualified pensions predates even the establishment of the Social Security system in 1935. Statutes enacted in 1921 and later, covering income from trusts and pension plans, were designed to encourage the expansion of pension coverage and increased saving levels and to provide a private source of retirement security. The tax treatment accorded more recently developed retirement and capital accumulation vehicles such as individual retirement accounts (IRAs), simplified employee pension plans (SEPs), section 401(k) plans, and qualified voluntary employee contributions (QVECs) indicates continued Congressional interest in increasing voluntary individual retirement savings.

The federal tax system is the most important factor influencing benefit growth. The tax code makes benefits cost-effective as compensation and encourages the broad coverage of employees. The tax code makes benefits cost-effective by providing a tax deduction for employers and preferential tax treatment for employees. As a result, a dollar in benefits may be worth more to the employee than a dollar in cash wages.

The tax code encourages employers to extend their benefit coverage to lower- and moderate-income employees. The preferential tax treatment accorded benefits is contingent upon compliance with the tax code's nondiscrimination provisions governing coverage of the employer's work force.

Historically, the tax code has also worked with inflation to encourage benefit growth as protection against inflation-driven increases in real marginal tax rates. During the past twenty years, inflation has pushed most taxpayers into higher marginal tax brackets, despite legislation lowering nominal tax rates for the different income levels. This "bracket creep," the gradual increase in real marginal tax rates, has prompted the use of noncash benefits to stem the erosion of real income. Up to 30 percent of the benefit growth over this twenty-year period may be attributed to attempts to alleviate inflation's impact on employee compensation.

While the tax code is a major factor encouraging benefit growth it is not the only factor. Employee compensation also depends on income growth, employer cost considerations, and employer and employee preferences.

What Does Pension Policy Cost?

Tax expenditures are commonly used in public policy debates as a measure of the social cost of federal pension policy. The Treasury estimates that pension-related tax provisions cost the federal government over $50 billion each year in lost revenues. Persistent federal deficits have called attention to Internal Revenue Code provisions that appear to subsidize select groups of taxpayers.

There is wide disagreement, however about the proper way to measure these costs and about who benefits from the incentives provided in these provisions. Tax-expenditure measures used in the federal budget process are calculated on a cash-flow or cross-sectional basis, with the amount of the taxes deferred by current pension plan participants offset against the amount of taxes paid by current beneficiaries. Measured this way, about $0.83 out of every tax-deferred dollar appears to be lost to the Treasury (see table 1). Such estimates overstate the amount of revenue lost due to such provisions, however. Because today's pension-plan participants will have higher retirement incomes than today's retirees, they will pay more taxes in retirement. Over their lifetimes, those employees now at the beginning of their pension careers will repay all but $0.25 to $0.40 of every tax-deferred dollar. As the pension system matures, the numbers and income levels of pension-plan participants and retirees will differ less than they do today. As a result, in the future, pension-related tax expenditures measured using the Treasury's approach will be much closer to lifetime estimates.[1]

Even this more realistic lifetime measure of tax expenditures probably

TABLE 1

How Much of Pension-Related Tax Deferrals is

Lost to the Treasury?

Method Used	Taxes Lost	Taxes Deferred
Treasury Method	83%	0%
Lifetime Method:		
Nominal dollars[a]	14	86
Real dollars[b]	28	72
Discounted for interest:[c]		
at pension rate	40	60
at federal rate	36	64

SOURCE: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, forthcoming).

[a]Before adjusting for inflation.
[b]After adjusting for inflation.
[c]Interest rate used to discount taxes paid in retirement to the year of retirement.

still overstates the revenue costs of pension-related tax policy. Taxpayers have access to many other tax-favored investment vehicles that could be used for retirement saving in place of employer pensions. In the absence of tax provisions favoring pensions, taxpayers would probably make more use of these vehicles. This would increase the revenue loss attributable to these alternative investments.

Tax expenditure statistics are also misleading because they imply that only advance-funded plans impose social costs. Tax deferrals are measured only on contributions and earnings actually received by plans, which means that a pension plan must be advance-funded to result in tax expenditures. The Employee Retirement Income Security Act of 1974 (ERISA) established minimum funding standards for private-employer defined-benefit plans, enhancing benefit security. In contrast, the Civil Service Retirement System (CSRS) and the Military Retirement System (MRS), the two major federal retirement plans, have little impact on tax expenditures because they are largely unfunded. Underfunded or unfunded plans, however, can cost the taxpayer much more in the long run. In sum, pension-related tax policy is not as costly as available revenue-loss estimates would suggest.

Who Receives Employee Benefits?

The expansion of employee benefits has primarily helped the middle income worker. Among employees who were covered by pensions in 1983, nearly 28 million (or 59.0 percent) earned less than $20,000 (Table 2). Among employed persons with employer-provided health coverage 83.7 million (or 74.3 percent) earned less than $20,000, and 23.2 percent earned between $20,000 and $50,000. Fewer than 3 percent of pension and health insurance participants earn more than $50,000.

The distribution of pension-related tax benefits among income groups reflects the distribution of coverage and participation. The largest share of lifetime pension-related tax benefits accrues to middle-income employees. In 1979, 34 percent of employees aged 25 to 34 earned between $20,000 and $50,000. These employees will receive 53 percent of the group's pension-related tax benefits (table 3). Those employees age 25 to 34 who earned $20,000 or less will receive 24 percent of their group's lifetime pension-related tax benefits, while 22 percent will go to those earning over $50,000.

Employee benefits are now a mainstay of the middle-income worker's income security, providing hazard protection as well as building assets. As much as a fifth of all spending on health care is now made through employer-sponsored plans.[2] Pensions also result in a progressive redistribution of wealth that favors those at the lower end of the income scale who do not tend to save much out of current income.

This redistribution can be demonstrated by comparing data on pension coverage and income from savings as reported in the 1983 Health and Human Services (HHS) and Employee Benefit Research Institute (EBRI) Current Population Survey (CPS) Pension Supplement, the best available source of information on pension coverage. Direct information on savings would be preferable to the data on income from savings, but it is not available on a current basis.

Accumulated pension benefits constitute the major form of savings for more than half of all persons with pension coverage. According to the CPS,

TABLE 2

Distribution of Employees with Pension and Health Coverage

by Earnings

Earnings	Employees with Pension Coverage, 1983		Employees with Health Coverage, 1983	
	Total (in millions)	Percent	Total (in millions)	Percent
Less than $20,000	27.9	59.0	83.7	74.3
$20,000 to $49,999	18.1	38.0	26.2	23.2
$50,000 and over	1.4	2.9	2.7	2.4
Total a/	47.4	100.0	73.0	100.0

SOURCE: EBRI tabulations of U.S. Census Bureau Current Population Survey, 1983 and EBRI-HHS Current Population Survey Pension Supplement.

a/ Detail may not add to totals due to rounding. Totals include only those health and pension plan participants who reported their earnings in the Survey. When those not reporting their earnings are added, coverage totals are higher.

TABLE 3

Net Lifetime Pension-Related Tax Benefit Shares
Among Employees Aged 25 to 34

Income[a]	All Persons (Percent)	Pension Participants (Percent)[b]	Lifetime Tax Shares by Income Class[c] (Percent)	Lifetime Pension Benefit Tax Shares by Income Class (Percent)
$20,000 or less	61	53	42	24
$20,001 to $50,000	34	41	42	53
$50,001 or more	5	6	16	22

Source: EBRI calculations based on PRISM simulation results.

[a]Total 1979 income in 1983 dollars.
[b]Includes not only those who were pension participants in 1979, but also those in this age group who are projected to acquire pension coverage later in their careers.
[c]The share of lifetime taxes paid by those with base-year incomes below $50,000 is higher than their share of current-year taxes, because their lifetime incomes are higher than their current-year incomes. In 1982, taxpayers with incomes over $50,000 paid 35.4 percent of total income taxes. U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income Bulletin, Winter 1983-1984 (Washington, D.C.: Internal Revenue Service, 1984), p. 20.

more than 40 percent of the labor force reported no savings income in 1983 (table 4). This group's average income was $9,651, just under half the average income of those reporting some asset income. Some 55 million workers, including almost half of the group reporting little or no savings income on the CPS, were covered by employer pensions in 1983. Pensions thus constituted a net increase in savings for these workers. Assessments of pension-related tax policies should consider the net increase and redistribution of wealth that results from expanded pension coverage.

What Does Society Get in Return?

Tax benefits are not the only advantage received by pension participants. Whatever the revenue cost of the pension-related tax-code provisions, sound retirement policy design requires that this cost be measured against the social benefit of increased savings and higher benefit levels.

Increased savings. Pensions both increase and reallocate total savings. If pension contributions were received as cash income, total saving would decrease. The drop, moreover, would be relatively greater among lower- and moderate-income employees. While nonpension saving is concentrated among relatively high-income individuals, pensions are distributed broadly among income groups.

Pensions also change the distribution of saving among investment vehicles. Nonpension saving consists primarily of liquid saving deposits and investments in owner-occupied homes or other consumer durables. Pension funds, in contrast, are invested in securities that finance productive capacity and employment. Pension funds have grown to be the single largest supplier of investment funds to financial markets. At a time when unmet

TABLE 4

Savings, Pension Coverage, and Income, 1983

Savings Status[a]	Employees Covered[b] (Millions)	(Percent)	Employees Not Covered (Millions)	(Percent)	Average Annual Income (Dollars)	(Percent)
No savings	18.2	19.0	20.6	21.5	$ 9,661	40.5
Some savings[c]	36.9	38.4	20.3	21.1	19,209	59.5
Total	55.1	57.4	40.9	42.6	15,338	100.0

Source: EBRI calculations based on preliminary data from the Bureau of the Census, Current Population Survey (May 1983).

[a]Individuals are classified as having some savings or no savings based on 5hether or not they reported any asset income in response to the survey questions. Asset income includes interest, dividends, rents, and royalties.
[b]Coverage refers to public- and private-sector pension plans and includes holders of IRA or Keogh accounts.
[c]Includes individuals reporting negative asset income (i.e., decreases in asset values).

capital financing needs are emerging throughout the economy, the fact that pension funds provide long-term capital gives them an important role in economic policy.

Increased Retirement Income. The availability of a pension often means the difference between subsistence and the ability to maintain pre-retirement living standards in retirement. Recent EBRI research projects that over the next forty years real retirement incomes will more than double. The average annual retirement income for those reaching age sixty-five in the 1980s is projected to be $13,376 per household in 1983 dollars. It is expected to increase to $26,802 for those retiring between 2010 and 2019.[3] Average employer pension benefits will increase from $5,315 for those retiring in the 1980s to $12,417 for those retiring betweeen 2010 and 2019. The proportion of new retiree households receiving pension income will grow from 37 percent in the 1980s to 71 percent by 2019.[4]

Tax payments by retirees will reflect this income growth. Pension beneficiaries retiring in the 1980s will pay an average of $15,808 in taxes (1983 dollars) on their benefits over the course of their retirement.[5] Pension beneficiaries retiring between 2010 and 2019, in contrast, will pay an average of $44,672 in taxes (1983 dollars) on pension benefits during their retirement.

Retirees not only receive larger retirement incomes as a result of employer pensions, but their benefits are more secure due to legally mandated advance funding. This security is all the more important as debates over the fiscal stability of the Social Security system continue. Social Security benefits and employer pension benefits complement each other. As pension benefits increase, Social Security benefits become a smaller share of retirement income. If public policy continues to encourage increased pension coverage and benefit levels, the pension system could reduce the pressure for ever-increasing Social Security benefits.

Alternative Ways to Accomplish the Goals of Pension Policy

Some have suggested that the goals of employer pensions should be accomplished using other policy approaches. Two of the alternatives frequently suggested are expanding the allowable deductions for individual retirement accounts (IRAs) and increasing benefits under the Social Security program.

Employer-provided pension coverage is more widespread than IRA participation. Preliminary EBRI results from the HHS-EBRI CPS Pension Supplement suggest that middle- and higher-income individuals were the primary beneficiaries of the broadening of IRA eligibility. An estimated 31 percent of households reporting incomes of $15,000 or higher hold IRA accounts, compared with 9 percent of households with incomes below $15,000. By comparison, almost five times as many workers earning less than $15,000--43 percent--are covered by employer pensions. Since IRAs by their very definition do not have any nondiscrimination standards protecting the interests of those at the lower end of the income scale, expanding IRA limits would provide nothing for these households.

Expanding the Social Security program at the expense of employer pensions would present a different set of problems. Most researchers agree that the Social Security payroll tax as it is currently constituted is regressive. The American people would almost surely demand that the tax be restructured if it were to increase significantly. It is unlikely, furthermore, that the federal budget system would be able to tolerate the spending and tax increases that would be necessary if Social Security were to become the sole guarantor of post-retirement living standards across the income spectrum.

Flexible Compensation Plans

The labor force is changing rapidly. Census data show that over the last decade, the proportion of single-adult households with children increased by one-third. Over half of married women are now in the labor force. Single-adult and two-earner households have different benefit needs than the traditional single-earner, two-parent family. Many of these households need child care, and may have different health- and life-insurance needs than either traditional families or single persons.

Flexible compensation plans have emerged as some employers' effort to respond to the needs of a diverse work force without adding to compensation costs to accomodate each additional group.[6] Most flexible compensation plans allow employees to trade benefits in one area for increases in other benefits. A two-earner couple, for example, can trade redundant health coverage for other benefits such as dependent care, increased life insurance, or added vacation time.

Flexible compensation plans are a relatively new development in employee benefits that is now becoming fully delineated. While some flexible compensation plans existed as early as 1972, Section 125 of the Internal Revenue Code was enacted in 1978 to extend the statutory protection from taxation that applies to other employee benefits to plans that give employees some choice over the mix of employer-provided benefits they receive. The statutory authority for these plans has been in place for six years, but the Administration issued preliminary regulations governing the implementation of these plans in May of this year.

Cafeteria plans, as they are also called, have grown considerably since they were first authorized. In a recent variation of these plans, about a third contain reimbursement accounts or flexible spending accounts (FSAs). FSAs allow employees to pay for unreimbursed medical expenses and some other benefits with pre-tax dollars. Such accounts are used to cushion the impact of a change in the employer's health insurance plan that might otherwise be seen as a benefit takeback. An estimated 1.5 million employees now participate in plans with flexible spending accounts alone, and as many as five million may be participating in cafeteria plans as a whole.

The Congress and the Administration have recently become concerned about the potential revenue impacts of flexible compensation programs that incorporate FSAs. Estimates of the federal revenue effects of FSAs differ widely. This divergence of estimates stems from differing assumptions about the design of these programs, distribution of participants among various types of programs, and the elections that participants make. FSAs instituted in conjunction with a leaner health plan probably contribute to slowing down the growth of benefits as a share of compensation because health care costs are the fastest-growing employee benefit.

Employers with flexible compensation plans have found that the ability to choose increases employees' satisfaction with their benefits even when the dollar value of the benefits package is unchanged. This can reduce the pressure on employers to increase benefits to maintain a competitive compensation package. The ability of employers and employees to use flexible compensation to contain benefit cost growth suggests that these plans can have important macroeconomic effects by stabilizing benefit growth and labor costs. Stabilizing benefit growth will keep wages and salaries a constant share of total compensation. This would mean that a constant share of total compensation would be received in a taxable form. Stabilizing labor costs, in turn, can contribute to reduced production costs throughout the economy.

Recent Legislative Actions and Prospects For the Future

Employee benefits issues have played a major role in recent tax policy debates. For example, in the Tax Reform Act of 1984, the Congress made significant changes in at least sixteen areas of employee benefits. These included:

> employee stock ownership plans; cost-of living adjustments in pension plan limitations; individual retirement accounts; group term life insurance purchased for employees; funded welfare benefit plans; unfunded deferred benefits; distributions in qualified pension plans; top-heavy plans; estate-tax treatment of qualified pension plan benefits; pension plan rules for affiliated service groups, employee leasing arrangements, and collective bargaining agreements; cash or deferred arrangements; treatment of certain medical and other benefits under section 415; the statutory treatment of certain employee benefits; pension-plan terminations; voluntary employee benefits associations; and rules governing multiemployer plans.

The importance of employee benefits in tax policy promises to continue as the Congress tries to deal with projected federal deficits. Both the Congress and the Administration have expressed considerable interest in basic reform of the personal income tax. At least a dozen basic tax reform proposals were introduced in the 97th Congress and more were introduced in the 98th Congress. President Reagan has also asked that the Treasury department analyze basic tax reform options and prepare a report by December 1984.

In general, basic tax reform proposals would lower marginal tax rates and expand the income tax base.[7] Basic tax reform proposals offer ways to restructure--not lower--the nation's tax bill. Most proposals do not envision widespread tax cuts, but would instead change the distribution of tax liability among individuals. This would be done by expanding the tax base to eliminate many tax preferences in current law, including those governing the tax treatment of employee benefits. With a broader tax base, marginal tax rates on income could be lowered.

At the heart of the basic tax reform movement is the widespread belief that the tax system is unfair and inefficient. The proliferation of tax preferences can mean that differences in tax liability among individuals stem as much from the ability to manipulate the tax system as from differences in ability to pay. Energy is spent utilizing tax preferences and loopholes that could be spent on more productive activities. High marginal tax rates encourage taxpayers to seek out tax-favored sources of income--capital gains, for example--and tax-favored uses of income, such as housing. As a result, investment and other economic decisions are often driven by tax needs as much as by economic returns and productivity considerations. An advantage often cited for expanding the tax base and reducing marginal tax rates is eliminating this effort by making the tax code more neutral in economic decisions.

The arguments for broadening the tax base have attracted a wide range of political support. Conservatives support broadening the tax base as a way of eliminating the income-earning disincentives and market interference of high marginal tax rates. Liberals support broadening the tax base as a way of eliminating tax-code provisions perceived to benefit primarily the rich.

Recent tax-reform debates have centered around the comprehensive income tax and the consumption tax.[8] The basic premise behind the comprehensive income tax is that individuals should be taxed on the value of what they produce, as represented by income. A comprehensive tax attempts to tax both actual and imputed income. Comprehensive income tax proposals include in taxable income not only cash wages but also all other items of value received by the employee as compensation.

The basic premise behind the consumption tax is that individuals should be taxed not on the economic value they generate but rather on what they use up--or the share of income that is not saved. The consumption tax would exclude all forms of saving from taxable income until the funds were used for consumption. The consumption tax would tax all employer contributions for benefits that do not result in saving. This includes various employee benefits that provide insurance protection, but does not include pension or capital accumulation plans, since they result in saving.

Three recent legislative proposals implement these principles. These proposals illustrate some of the tradeoffs in basic tax reform. All of them combine tax rate reduction with tax base expansion, with implications for most employee benefits.

Comprehensive Income Tax

Senator Bill Bradley (D-NJ) and Representative Richard Gephardt (D-MO) have introduced a comprehensive income tax proposal (S.1421/H.R.3271). It would raise the same amount of revenue as current law by using only a three bracket tax-rate structure: 14, 26, and 30 percent. The reduced rate structure would be financed by eliminating or cutting back approximately forty current-law tax preferences. Tax preferences that would be retained include deductions for home mortgage interest, charitable deductions, state and local property and income taxes, and some medical and business expenses. All employer contributions for benefits other than pensions would be included in the employee's taxable income. The Section 415 limits on pension benefits and contributions would be made much more restrictive than under current law.

Senator Mark Hatfield (R-OR) has also introduced a comprehensive tax proposal (S.2158). Under this proposal, most deductions, credits, and exemptions would be repealed, and many items currently excluded from adjusted gross income would be included. The Hatfield proposal would retain current-law treatment for employer-provided pensions, but all other employer contributions for benefits would be included in taxable income. There would be six tax brackets, ranging from 6 percent to 20 percent. The current structure of exemptions and deductions would be replaced by five tax credits for the taxpayer, spouse, and dependents; and for portions of charitable contributions, home mortgage interest, taxes paid, and medical expenses.

Consumption Tax

Senator Dennis DeConcini (D-AZ) has introduced a consumption tax proposal (S.557). Under this proposal, all income other than that used for investment would be taxed at a marginal rate of 19 percent. This tax structure would be financed by eliminating nearly all current law tax preferences. All income would be taxed once, and as close to the source as possible. Advocates of such a tax structure argue that it would eliminate allowing income to escape taxation entirely, while other income is taxed more than once.

Contributions and benefits in retirement-income programs would retain their current tax-law treatment. The employer's contribution for health, welfare, and "fringe" benefits, however, would no longer be tax deductible as an employer compensation expense. Employees would not be taxed on the value of employer contributions for nonpension benefits since the employer would already have paid tax on these contributions. Since cash compensation would continue to be a tax-deductible cost of doing business to the employer, the employer would presumably have an incentive to offer more compensation in cash than in benefit contributions.[9]

Comparing Major Basic Tax Reform Proposals

All three proposals discussed above, though they are based on different tax principles, would result in similar treatment for many benefits. Tax preferences for most employer-provided benefits would be eliminated. Employer contributions for nonpension benefits would be treated as taxable income. Had such a provision been in effect in 1982, an estimated $72.9 billion would have been added to that year's taxable employee compensation (Table 5). Federal tax revenues, as measured by the U.S. Treasury's calculations of tax expenditures attributable to these benefits, could have been as much as $19 billion higher, assuming current-law tax rates.[10]

The primary differences among these proposals are in their treatment of retirement income programs. The DeConcini and Hatfield proposals would continue the current-law treatment of pensions. The Bradley-Gephardt proposal, however, would impose more restrictive benefit and contribution limits under Section 415 of the Internal Revenue Code. Limits on allowable benefits in defined-benefit plans would be reduced from $90,000 under current law to $60,000; contribution limits in defined-contribution plans would be lowered from $30,000 to $20,000; and indexing of these limits would be eliminated. The immediate effects of this change would be felt primarily by

TABLE 5

Employer Contributions and Treasury Department Tax Expenditure Estimates

for Selected Voluntary Benefits a/

(in billions of dollars)

Benefit Contributions	Employer Cost b/ (1982)	Federal Tax Expenditures (1982)
Health insurance	$65.7	$16.4
Life insurance	7.2	2.0
Accident and disability insurance	NA	0.1
Other employer-provided benefits: child care, educational aid, legal services plans	NA	0.6

SOURCES: Employer cost data from table 6.15 in U.S. Department of Commerce, Survey of Current Business vol. 63, no. 7 (July 1983), p. 74. Tax expenditure data from Executive Office of the President, Office of Management and Budget, The Budget of the United States, Fiscal Year 1982, Special Analysis G.

a/ Voluntary benefits are those not mandated by law. Examples of mandatory benefits are Social Security benefits and unemployment compensation.
b/ Totals cover both private- and public-sector employees.

higher-paid persons. The longer-term repercussions could be much broader, however. As many as 20 percent of younger pension participants could be directly affected, and many more could be affected indirectly by the adjustments plan sponsors could be forced to make.[11]

These proposals, therefore, would change the relative attractiveness of cash and benefits as forms of compensation. They would also change the relative attractiveness of various benefits. In general, tax policy under these proposals would continue to provide some encouragement for benefits that constitute capital accumulation, but benefits that provide current protection would be cut back.

Conclusions

Critics of employee benefits allege that benefit-related tax provisions are regressive, providing tax shelters for the wealthy and little or no benefits for anyone else. EBRI research, using data collected by the federal government and projections based on these data, shows conclusively that this is not the case. Rather, the distribution of employee benefits follows the overall distribution of income very closely; the middle class gains the most from employee benefits.

There is much unfinished business in employee benefits, however. The recent recession, combined with long-term interindustry shifts in employment, appears to have reduced pension coverage rates from pre-recession levels. While the economy is now recovering, the damage done to benefit coverage levels will take longer to repair. Employers in low-coverage sectors and in small firms will need time and a secure economic environment to establish employee benefit plans. A secure economic environment means not only a healthy economy but also a stable regulatory environment. A pension plan in particular requires a long term commitment from both the employer and the employee if it is to deliver a meaningful retirement benefit. Employers will not make this commitment if they expect the terms on which it is delivered to change with every change in the political and budgetary environment. Therefore, Mr. Chairman, we ask that the Congress recognize how much it has already achieved in safeguarding the economic security of the American worker and that it renew its commitment to encouraging private provision for economic security.

NOTES

1 For further analysis of these issues, see Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, D.C.: EBRI, forthcoming). See also Issue Brief "Pension-Related Tax Benefits," no. 25 (December 1983) and Issue Brief "Employee Benefits and the 1985 Reagan Budget," no. 27 (February 1984).

2 Unpublished estimate, EBRI.

3 Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, D.C.: EBRI, 1982), p. 100.

4 Ibid., p. 90.

5 Unpublished EBRI tabulations of PRISM simulation results.

6 For background on flexible benefits plans and their relevance to changing employee needs, see Dallas L. Salisbury, ed., America in Transition: Implications for Employee Benefits (Washington, D.C.: EBRI, 1982); Issue Brief "Flexible Compensation and Public Policy," no. 24; and Chapter XXII, "Flexible Compensation Plans" in Fundamentals of Employee Benefit Programs (Washington, D.C.: EBRI, 1983).

7 For a detailed discussion of the mechanics of basic tax reform, see EBRI Issue Brief "Basic Tax Reform: Implications for Employee Benefits," no. 28 (March 1984).

8 Both tax systems would require detailed judgments about the treatment of various sources and uses of income. Both would also create some formidable implementation and transition problems. These problems and issues are treated in detail elsewhere. For a discussion of employer pensions in basic tax reform, see Sophie Korczyk, Retirement Security and Tax Policy (Washington,

D.C.: EBRI, forthcoming). For a wide-ranging discussion of theoretical and practical issues in basic tax reform, see U.S. Department of the Treasury, Blueprints for Basic Tax Reform (Washington, D.C.: Government Printing Office, 1977).

9 This argument is advanced in Robert E. Hall and Alvin Rabushka, Low Tax, Simple Tax, Flat Tax (New York: McGraw-Hill Company, 1983), p. 90.

10 Actual revenue gained from removing tax preferences for employee benefits would be lower because tax rates would be lower and because employers and employees would change their behavior to avoid taxes.

11 See Retirement Security and Tax Policy, Chapter VII.