The Economic Costs of the Uninsured
By Stephen Blakely, EBRI

Most Americans have health insurance protection, but for more than a decade the proportion of nonelderly Americans without health insurance has been steadily creeping up. Today, some 44 million people in the United States—18.4 percent of those under 65—do not have insurance coverage to pay for their health care.

But it is widely recognized that people without health insurance still receive health care. The uninsured are not staying out of the health care system; rather, they are receiving higher-cost medical care (through emergency room visits), and they are forcing others to pay for their health care. Economists say these costs are picked up in various ways: by businesses and their employees, in the form of higher premiums for their insurance; by workers, in the form of taxes; and by all Americans, in the form of an opportunity cost in lost value to the U.S. economy.

Employers in both the private and public sectors are the dominant source of health insurance for nonelderly individuals in the United States, providing coverage for nearly two-thirds of this under age 65 population in 1998. But increasingly, the uninsured are being viewed as a challenge to and criticism of the employment-based health care system in this country—not just because the ranks of the uninsured are growing, but also because roughly 85 percent of the 44 million uninsured Americans are in a family with a working adult. As a result, many critics see the employment-based health insurance system as a failure, and are calling for it to be replaced with an individual-based system.

However, even an individual-based system would not change the reality that health insurance in the United States is voluntary: Employers are not legally required to provide coverage to their workers, and individuals are not legally required to maintain coverage. In this kind of system, some segments of the working population will have coverage, while others will not. In addition, it is often overlooked that there are effectively two employment-based health insurance systems—one for small employers (where coverage rates are low) and one for large employers (where coverage rates are high). And, mandated solutions are not as simple as they might seem, as indicated by experience in the states concerning noncompliance with income tax, driver’s license registration, or automobile insurance.

Should employers be concerned about the uninsured population? Are there adverse consequences to driving employers out of the health care delivery system? Is there a link between health insurance and the health of the population, productivity, and economic output? What are the private
and public sectors doing to increase access to health insurance coverage?

Policymakers, leading thinkers on benefits, employers, and labor representatives examined these questions during the May 3, 2000, policy forum on “The Economic Costs of the Uninsured,” sponsored by Employee Benefit Research Institute Education and Research Fund (EBRI-ERF). Attended by about a hundred invited experts, the policy forum examined the research that has been done connecting health insurance status to the performance of the economy, and the implications for consumers, business, and government. While this is hard to quantify, economic research is beginning to show there may be real business costs connected to the uninsured.

“Ultimately,” said Paul Fronstin, EBRI senior research associate, “the question is whether employers view health as a cost or as an investment.”

Workers and Access to Health Care

It has been well documented that employment-based health insurance offers benefits to both workers and employers. For workers, it provides financial protection against unexpected events; it gives them access to a product at a discounted group rate (especially compared with individual rates), and it gives them a benefit on a pre-tax basis. For employers, health benefits are a powerful tool to attract and retain skilled workers, and the costs of any subsidized health insurance premiums that they pay are tax-deductible. For both employers and workers, health insurance allows workers to maintain their productivity.

Who are the uninsured?

Fronstin noted that research has found they tend to have certain characteristics: They are more likely to be part time, low-income, in blue-collar and “service-collar” jobs concentrated in certain industries (such as agriculture), young (the average uninsured worker is 31 years old, compared with 37 for all workers), single, less educated, minority, a noncitizen, and employed by a small firm. For instance, 27 percent of workers in firms with fewer than 100 employees were uninsured in 1998—more than twice the rate (12 percent) for workers in firms with 100 or more employees.

Although the uninsured do get health care, EBRI research has shown that health insurance clearly affects access to this care. For instance, uninsured workers are less likely to have had a complete physical in the past year than those who have insurance; they are less likely to have had a flu shot or their cholesterol checked in the past year; and they are less likely to have had preventive gender-based examinations, such as mammograms or prostate exams.

Significantly, even though uninsured workers are younger than the average worker, they are not necessarily healthier. EBRI research also found that those without health insurance were more likely to smoke, less likely to get regular exercise, less likely to eat fruits and vegetables on a daily basis, and less likely to use seat belts than those who have health coverage.

The Economic Costs of the Uninsured

Alphonse Holtmann, of the University of Miami, noted that health care differs from other types of services that people buy because it can increase current and future productivity. For instance, flu shots are likely to reduce the number of workdays lost due to illness, and health checkups are more likely to detect illnesses at an early stage, also increasing productivity in the long run. He suggested that employers get a substantial benefit from this because wages are offset to cover the cost of health insurance and because the costs of health insurance are tax deductible.

Using data from the Census Bureau’s 1999 Current Population Survey, Holtmann measured the insurance status, wage levels, and self-reported health status of 54,000 wage and salary workers. He found that in general, healthy men working full time, full year earn between $3,500 and $4,900 more per year than less healthy men, and that healthy women working full time, full year earn between $1,700 and $4,200 more than less healthy women. Based on economic modeling, Holtmann estimated that in mid-sized firms (with 100–499 employees), expected gains in earnings attributable to health insurance account for 18 percent of the cost of insurance for males and...
Research using the California Work and Health Survey found that “people without health insurance are less healthy than those who have it,” according to Edward Yelin of the University of California at San Francisco. The survey determined that people without insurance are more likely to report fair or poor health, a high level of depressive symptoms, and limitation in activities, than those with health coverage.

Yelin added that these findings do not result from demographic characteristics of the individual or employment status, which suggests that “there is something inherent in insurance” that contributed to better health. But even though people with employment-based coverage are healthier than those who are uninsured, he noted, “whether this is due to the insurance is not clear.”

Another study, conducted by Dee Edington of the University of Michigan, looks at health care cost controls using data from the university’s Health Management Research Center (UMHMRC) Corporate Consortium, based on the experience of the seven major corporations studied over a seven-to-18 year period and including nearly two million covered lives. The study measures health in terms of health care costs; workers’ compensation; and workers’ disability, absenteeism, or productivity.

Edington stressed the difference between health risk management and health care management, noting that employers must ultimately focus on managing their workers’ health risks in order to control health costs. In the experience of the UMHMRC companies, health risk management programs costs between $10 and $100 per year per employee, while health care insurance per contract is approximately $6,000. While the traditional management approach has been to concentrate on ways to reduce the number of high-cost (and unhealthy) workers, Edington said his research indicates the greater cost-saving opportunity is to keep the low-cost employees low cost—by keeping them healthy.  

Private- and Public-Sector Initiatives

Even as the number of uninsured continues to climb, both the private and public sectors are working on initiatives to increase health insurance coverage. Both sectors recognize that the lack of coverage for a significant percentage of the population may affect population health and the well-being of the community and the economy.

One local initiative is the Institute for a Competitive Inner City (ICIC), which attempts to spur economic development around the country by working with fast-growing, successful inner-city companies. ICIC has a joint program with Inc. Magazine, called the Inner City 100 Program, designed to identify and publicize 100 of the fastest-growing inner city companies in the United States each year. The goal of the program is to highlight “success stories in places people don’t expect to see them,” according to Stephen Adams of ICIC, in order to get private investors to realize that inner-city areas can be profitable. Adams noted that these firms, despite being mostly small, also provide benefits: About 96 percent of the companies sponsor health care coverage for their workers, and 72 percent provide retirement plans.

Of the most well-known and closely watched efforts at expanding small-business insurance coverage is the Alliance Chamber Health Insurance Program (A-CHIP), which was initiated by the Greater Madison (Wisconsin) Chamber of Commerce in 1990 and currently serves a three-county region of south-central Wisconsin and involves 27 local Chambers of Commerce. It is an employer-owned and -directed health care cooperative, and has grown from just seven companies to about 170 self-funded firms and 1,000 fully insured small employers.

According to Chris Queram of A-CHIP’s Employer Health Care Alliance Cooperative, the original concept was to create a “managed competition” health plan model, incorporating annual premium ceilings, community rating, and a “common pool” approach that would include self-employed workers. While A-CHIP enjoyed initial success, and this year celebrates its 10th anniversary, Queram said the program has encountered some serious challenges that are threatening its profitability.
Among the problems have been a lack of governmental sponsorship or support, competition from local health plans, lack of support from local insurance agents, and a disproportionate share of self-employed workers. Currently, the program is losing money in two of the three counties where it operates.

Because insurance is generally regulated on the state level (except for self-insured plans), most of the innovative public-sector initiatives have involved insurance reform at the state level. Two of the more active states have been Maryland and Oregon.

According to John Colmers of the Maryland Health Care Commission, most new initiatives on health insurance coverage issues are occurring at the state level for a variety of reasons. Due to the prosperous national economy, many states have budget surpluses. In addition, revenue from tobacco-related settlements have a number of states focusing on ways to improve health care access and services. He also argued that state governments and the business sector have a common interest in expanding employment-based health insurance coverage, because it spurs economic development and is more efficient.

States can help increase health insurance coverage within their borders by using innovative state programs that utilize federal funds (such as through Medicare or the State Children's Health Initiative Program, or S-CHIP), and by providing state-level tax incentives and special purchasing arrangements for the small-group market, Colmers said. But he added that "it's a very tricky business" to impose new state health laws and regulations on employers without causing negative or unintended consequences, and that federal pre-emption of certain state laws under the Employee Retirement Income Security Act of 1974 (ERISA) complicates state initiatives.

Mark Gibson, of the Oregon governor's office, outlined the four initiatives that his state has undertaken to expand commercial health insurance coverage: a high-risk pool for individuals who are otherwise uninsurable; reforms to state insurance laws governing the small-group market (two to 50 lives); a state subsidy for low-income people to purchase health coverage; and assistance with small-firm health purchasers' coalitions, similar to A-CHIP.

But Gibson added "one of the key elements" that allows Oregon's private insurance market to operate as well as it does is the fact that the federal Medicare and Medicaid programs provide coverage to the elderly, the disabled, and the poor. "They [Medicare and Medicaid] take some of the worst risks going," Gibson said. "If we were relying on the private sector to compete for the infirm elderly, the costs would be entirely different in our system."

**The Influence of Business and Labor**

Another innovative approach to health coverage, beyond cooperation between the public and private sectors, is cooperation between labor and management. One of the more remarkable initiatives in that realm is the joint effort by General Motors and the United Auto Workers to encourage the development of community health care delivery systems in areas where they have large populations of employees and retirees.

As Gary Pheley of GM put it, this project brings a lot of people and money to the table: 1.2 million covered lives and about $3.5 billion spent on health care each year. Pheley said the thrust was to focus on the health status of their communities and to make sure that both the workers and the company got what they were paying for by sharing information on the quality of care they received from their health insurance. The result has been to force health care providers and insurers to quickly improve their services where lapses or problems have been identified.

"It's our philosophy that by focusing on quality and by eliminating waste in the system, your costs will eventually be reduced as well," Pheley said. "Cost is certainly an issue, but the driving force here is quality." The overall goal, he added, is to encourage disease prevention and accident prevention, expand health education, and thereby improve community health status.

David Hirschland of the UAW reviewed several specific projects, such as a hospital "report card" initiative, an information program to help provide standard-
ized consumer information on health maintenance organizations (HMOs), and a project in Michigan designed to reduce overuse of antibiotics.

In each case, he said, the initiative involved coalitions of local and national groups, and in all cases the biggest challenge was collecting objective information on health care services in a standardized format that could be easily compared. Because of regional and institutional differences in the ways medical data are reported, Hirschland said, coming up with consistent reporting formats and uniform measurements has proved difficult.

**Options for Enhancing the Employment-Based System**

Given the complexities and dilemmas relating to the uninsured, how could the existing health coverage system be enhanced? And given the known benefits of having health insurance, how can coverage be increased? In 1999, the Commonwealth Fund, a philanthropic foundation in New York, set up a Task Force on the Future of Health Insurance for Working Americans to address these questions.

The task force recently issued four reports designed to help policymakers grapple with incremental strategies to make health insurance more accessible and affordable. The reports address the issues of health insurance and low-income workers, the insurance crisis facing the Hispanic population, risks for mid-life Americans (ages 45–64), and younger adults (ages 19–29), who have the highest uninsured rate.

Among the approaches outlined in the reports are federal subsidies to encourage individual-based coverage, through tax credits; expansions of existing federal programs, such as Medicaid and S-CHIP; new types of purchasing arrangements, such as opening the Federal Employee Health Benefit Plan to allow individuals and small firms to purchase coverage through FEHBP, or trying to expand purchasing groups/coalitions to allow individuals and small employers to buy coverage; or some combination of all these approaches.

According to Lisa Duchon of the Commonwealth Fund, the Task Force was designed to serve as an “honest broker” in assessing incremental and workable options to expand employment-based health coverage. But being realistic, she said, also means having limited expectations.

“Even incremental approaches are complex and costly, and there’s a limit to what we can do,” Duchon said. “There are only so many things to try.”

**Recent Evidence on Pension Coverage and Sponsorship, by Employer Size and Industry**

By Craig Copeland, EBRI, and Jack VanDerhei, Temple University and EBRI Fellow

According to an Employee Benefit Research Institute (EBRI) analysis of the 1998 data recently released by the Federal Reserve Board, 56.8 percent of families with a worker and a family head under age 65 were covered in a pension plan through a current job of either the family head or the spouse or partner of that person. Whether this level of coverage is sufficient has been subject to public policy debate for years; however, one issue on which there appears to be near-universal agreement is the need for increased sponsorship among small employers. For example, the small-business working group of the Advisory Council on Employee Welfare and Pension Benefit Plans issued a report in 1998 on pension coverage of employees of small businesses. It noted that pension coverage is nonexistent for a large majority of employees of small businesses. It noted that pension coverage is nonexistent for a large majority of employees of small businesses. The report proposed the repeal of Internal Revenue Code Sec. 416 top-heavy rules, which were enacted in 1982 because of perceived abuses among plans sponsored by small employers.
EBRI has previously analyzed the impact of employer size on pension plan sponsorship and found that higher estimated administrative costs reduce the likelihood of pension sponsorship among small employers. A subsequent EBRI publication focused on the impact of employer size with respect to the defined benefit/defined contribution evolution, and documented the significant decline in defined benefit plans for small employers during 1985–1993, using Form 5500 data. EBRI has recently released the results of the third annual Small Employer Retirement Survey, which surveys 600 employers with between five and 100 full-time employees to shed light on the primary reasons for low plan sponsorship rates among these employers. EBRI has also reported on industry-specific changes in coverage and sponsorship rates between 1988 and 1993.

This Notes article updates our previous analysis by exploring trends in sponsorship and coverage rates for family heads as a function of employer size and industry. In addition, coverage by pension plan types (defined benefit and defined contribution) is examined by employer size and industry.

### Distribution of Working Family Heads, by Employer Size and Industry

In 1998, almost 65 percent of working family heads worked for either the largest (500 or more employees) or smallest (fewer than 10 employees) employers in 1998, while 48.3 percent of these family heads were covered by a pension plan (table 2). Both of these numbers are virtually unchanged from 1992.

Both the sponsorship and coverage rates increase with employer size (table 2). In 1998, 11.1 percent of working family heads who worked for an employer with fewer than 10 employees were covered by a pension plan (an increase from 9.0 percent in 1992). For comparison, 69.5 percent of working family heads who worked for an employer with 500 or more employees were covered by a pension plan (a decrease from 73.2 percent in 1992). There are relatively large increases in this percentage as the employer size increases, before leveling off for the 100-employees-and-over categories. From 1992 to 1998, there was a decline in the coverage rate from 73.2 percent to 69.5 percent for working family heads who worked for the largest employers (those

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<th>Table 1</th>
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<tr>
<td>Fewer than 10 employees</td>
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<td>10-19 employees</td>
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<tr>
<td>Industry</td>
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<td>Agriculture, forestry, and fisheries</td>
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<td>Mining and construction</td>
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<td>Manufacturing</td>
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<td>Wholesale and retail trade</td>
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<td>Finance, insurance, real estate, business and repair services</td>
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<td>Transportation, communications, public utilities, and personal and professional services</td>
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Table 2

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<td>Head (percentage)</td>
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<td>All</td>
<td>61.3%</td>
<td>60.7%</td>
<td>61.1%</td>
<td>48.3%</td>
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<td>Fewer than 10 Employees</td>
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<td>7.9</td>
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<td>11.1</td>
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<tr>
<td>10–19 Employees</td>
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<td>22.3</td>
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<td>20–99 Employees</td>
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<td>73.2</td>
<td>70.6</td>
<td>86.3</td>
<td>69.5</td>
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with 500 or more employees, table 2). However, for working family heads who worked for employers with 100–499 employees, the percentage covered by a pension plan increased from 54.6 percent to 61.1 percent. The coverage rates for both working family heads who worked for employers with fewer than 10 employees and with 20–99 employees increased from 1992 to 1998, while the coverage rate decreased for those working for employers with 10–19 employees.13

The industry a family head works in is also an important determinant of whether the family head is covered by a pension plan. For example, 10.3 percent of the family heads who worked in the agriculture, forestry, and fisheries industry were covered by a pension plan in 1998, while 75.7 percent of family heads in public administration were covered by a pension plan (table 3). The coverage rates were relatively stable from 1992 to 1998 across industries. However, two exceptions resulted: a decrease in the coverage rate in the mining and construction industry (from 36.7 percent to 31.6 percent) and an increase in the coverage rate in the finance, insurance, real estate, and business and repair services industry (from 37.5 percent to 42.4 percent).14

Coverage by Pension Type Across Employer Size and Industry

In 1998, 21.3 percent of the working family heads who were covered by a pension plan were in a defined benefit plan exclusively, 60.7 percent were in a defined contribution plan exclusively, and 17.9 percent were in both a defined benefit and defined contribution plan (table 4). Thus, 78.6 percent of the working family heads who were covered by a pension plan were in a defined contribution plan. This was an increase of about 36 percent from the 57.8 percent level in 1992.

There was a significant increase in the percentage of working family heads who were covered by a pension plan in defined contribution plans across all employer size and industry categories from 1992 to 1998.15

Family heads who worked for the smallest employers were the most likely to be covered by defined contribution plans relative to the

Table 3

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<tr>
<td>All</td>
<td>61.3%</td>
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<td>61.1%</td>
<td>48.3%</td>
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<td>Agriculture, Forestry, and Fisheries</td>
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<td>Mining and Construction</td>
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<td>37.6</td>
<td>39.7</td>
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<td>Manufacturing</td>
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<td>Wholesale and Retail Trade</td>
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<td>49.8</td>
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<td>Finance, Insurance, Real Estate, Business and Repair Services</td>
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<td>51.2</td>
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Eighty-one percent of the family heads who were covered by a pension plan and worked for employers with 10–19 employees were in a defined contribution plan exclusively. For comparison, 57.9 percent of those family heads who were covered by a pension plan and worked for an employer with 500 or more employees were in a defined contribution plan exclusively. However, across all employer sizes, at least 74.2 percent of the covered family heads were in defined contribution plans in 1998.

Family heads covered by a pension plan experienced a large increase in the likelihood of being in a defined contribution plan across all industries. With the exception of public administration (52.8 percent), at least three-fourths of the covered family heads were in a defined contribution plan regardless of industry in 1998.

### Conclusion

The percentage of working family heads covered by a pension plan remained unchanged from 1992 to 1998 at 48.3 percent. Working family heads continued to migrate to the ends of the spectrum with respect to employer size—at both the smallest and largest employer size categories increased at the expense of those in the middle. This likely had offsetting effects, as small and large firms have the lowest and highest pension plan participation rates, respectively. Pension plan coverage rates by family heads increased for all employer sizes, except for the largest employers and for employers with 10–19 employees. All industry categories had stable coverage rates, except for mining and construction (decreasing), and finance, insurance, real estate, and business and repair services (increasing).

In all employer sizes and industries, family heads covered by a pension plan were far more likely to be in a defined contribution plan in 1998 than they were in 1992. Family heads working in public administration were much more likely to be in a defined benefit plan.
exclusively than any other industry, while those in all other industries and all employer size categories were more likely to be covered by a defined contribution plan.

Endnotes


2. The Survey of Consumer Finances (SCF) is used in this article to derive estimates of coverage in pension plans by family heads and rates of family heads working for employers who sponsor a pension plan. Family heads are the focus of this survey since SCF has a unit of observation of the family, not individuals. The SCF is a triennial survey conducted by the Federal Reserve to examine the wealth of families in the United States. In a forthcoming EBRI Notes, the Current Population Survey will be used to focus on individual worker coverage in retirement plans.

3. In EBRI publications, the fraction of all workers with an employer where a plan is sponsored for any of its employees is referred to as the sponsorship rate. The percentage of workers covered by a plan is the coverage rate, as opposed to participation rate, which is the percentage of workers who work for an employer that sponsors a plan, are eligible to participate, and do participate.


11. Ibid. Results from the 1993 CPS for a slightly different population yielded a sponsorship rate of 57 percent and a coverage rate of 44 percent.

12. Ibid. Using 1993 CPS information on a slightly different population, EBRI found participation rates of 14 percent, 34 percent, and 64 percent for plans with fewer than 25 employees; between 25–99 employees, and more than 100 employees, respectively. Sponsorship rates for these groups were 19 percent, 46 percent, and 83 percent, respectively. In contrast, Lichtenstein used data from the 1991 Small Business Administration Retirement Plan Survey and found that only 14.3 percent of small firms with fewer than 100 workers provided pension benefits, compared with almost 70 percent of large firms with 100 or more workers. See Jules H. Lichtenstein, “Factors affecting pension and health benefits availability in small and large business,” Benefits Quarterly, Vol. 14, Issue 1 (First Quarter 1998): 55–61.

13. The percentage of working family heads who worked for an employer of each size category that sponsored a pension plan followed the same trends from 1992 to 1998.

14. The percentage of working family heads who worked for an employer that sponsored a pension plan again followed the same trends as the participation rates across the industries.

15. See Copeland and VanDerhei, op cit., for participation by plan types across all families and family head demographics.
WASHINGTON UPDATE
by Teresa Turyn, EBRI

August Recess: The Legislative Clock Is Ticking

Congress began its summer recess July 31, breaking for the Democratic and Republican presidential conventions. Before leaving town, Congress passed a number of separate tax-cut bills with help from Democrats. The pension reform/tax cut measure sponsored by Reps. Portman (R-OH) and Cardin (D-MD) passed the House by 376 votes. Despite that margin, President Clinton is expected to veto or block the measure—creating even more campaign fodder for both political parties. However, wait until you see the pen move, as Clinton still wants a legacy that goes beyond his skillful use of the veto.

When lawmakers return after Labor Day, they have just five work-weeks left on their schedule to complete the Fiscal Year 2001 federal budget and a host of other must-pass measures, prior to their Oct. 6 target adjournment date. Even though the House passed a major pension-reform package before it recessed last month (see story below), every major benefit-related issue on Capitol Hill faces the same hurdle: Little time and lots of partisan politics. The weeks immediately after Labor Day will determine which benefit issues—if any—survive this year’s legislative process.

House Sends Pension Package to Senate

The full House of Representatives July 19 voted overwhelmingly (401-25) to pass a pension bill (H.R. 1102) that would increase the contribution limit for individual retirement accounts (IRAs) and raise the amount that workers could contribute to their 401(k) plans, provide for “catch-up” retirement plan contributions, and make pensions more portable. The legislation, called the Comprehensive Retirement Security and Pension Reform Act, has met with a cool reception at the White House and criticism from some Democrats, who describe it as the latest in a series of Republican bills that would benefit the wealthiest but do little for those with mid-range or low incomes. Obviously, most House Democrats did not agree.

During floor debate, lawmakers voted 221-200 to defeat a Democratic substitute that would have left the underlying bill intact while adding tax credits for small businesses, a revised version of President Clinton’s Retirement Savings Accounts proposal, a non-binding “Sense of Congress” resolution regarding enhanced disclosure and a ban on “wear-away” for cash balance plan conversions, and slightly different Sec. 415 multi-employer reforms.

Prospects for the measure are uncertain in the Senate, where opponents have more parliamentary tactics to delay or change the measure. Senate Finance Chairman William Roth, Jr. (R-DE) has expressed general support, however, and the hope that some pension reform legislation can be enacted this year (see article below).

Among other provisions, the bill would increase the annual contribution limit to a tax-free IRA from $2,000 to $5,000 by 2003, with an annual $500 increase thereafter. It would increase the annual limit on salary reduction contributions to tax-deferred 401(k) pension plans from $10,500 to $15,000 by 2005. To help those close to retirement age and stay-at-home mothers, the bill includes “catch-up” provisions: Those older than age 50 could contribute $5,000 to IRAs beginning in 2001 and could add another $5,000 to their contribution to a 401(k) plan.

In addition, the bill would ease pension portability on job change and allow workers to become vested in their pension plans in three years, rather than the current five. In addition, the bill would direct the Treasury Department to conduct a study on the benefit plateau effect that can accompany cash balance plan conversions (so-called “wear-away”) and then report back to Congress with legislative recommendations.

A complete description of the bill’s provisions by the Joint Committee on Taxation is available online at www.house.gov/jct/

Senate Passes Bill to Eliminate Estate Taxes; Pension Provisions Added

The Senate July 14 voted 59-39 to pass a bill (H.R. 8) repealing the
federal estate tax, sending the measure to a near-certain veto by President Clinton. The measure is one of several individual tax-cut bills that congressional Republicans are moving separately (such as the pension-reform bill, described above, and repeal of the “marriage penalty”). The president successfully vetoed earlier GOP attempts to move omnibus tax reduction legislation.

As passed by Congress, the bill would repeal the estate, gift, and generation-skipping taxes for transfers made after Dec. 31, 2009. Until then, estate tax rates would be reduced gradually over the nine-year period. Currently, only about 2 percent of estates are taxed by the federal government, but supporters of repealing the tax said many families and small-business owners are forced to pay thousands of dollars to lawyers and consultants for arrangements that protect their money from inheritance tax rates as high as 55 percent. The president called the estate tax bill “costly, irresponsible, and regressive,” and vowed to veto it.

As an amendment to H.R. 8, the Senate added a package of retirement savings provisions offered by Finance Committee Chairman William Roth, J r. (R-DE). The amendment contains provisions similar to the House pension reform bill (H.R. 1102) passed on July 19. Some of the common provisions include, among others, increasing the current-law annual IRA contribution limit to $5,000 within three years, increasing the maximum annual contributions to 401(k) plans to $15,000, and allowing for “catch-up” contribution provisions for plan participants age 50 and older.

Ways and Means OKs Bill To Repeal Tax on Social Security Benefits

The House Ways and Means Committee July 19 approved a bill (H.R. 4865) to repeal the 1993 tax on Social Security benefits and provide $44.6 billion in tax relief over five years. The bill would repeal the current-law provision that allows the federal government to consider as taxable income up to 85 percent of the Social Security benefits of individuals with income in excess of $34,000, and of married couples with incomes greater than $44,000. The measure was expected to go before full House before the August recess.

Investment Advice Bill Moves

The House Education and the Workforce Subcommittee on Employer-Employee Relations July 19 marked up a bill (H.R. 4747) that would amend ERISA to allow retirement plan participants to be given investment advice.

As currently drafted, the bill would change federal law to exempt investment advisory firms and their affiliates from the prohibited transaction rules that prevent them from offering investment advice. The measure would allow investment advisory firms to provide investment advice about all investment products, including their own, as long as material information is disclosed.

During the subcommittee mark-up, the panel voted 6-8 along party lines to reject a Democratic amendment that would have essentially retained current law, which requires investment advisory firms to obtain regulatory approval on a case-by-case basis before offering investment advice.

Opponents of the legislation include the Department of Labor, the AFL-CIO, and AARP. Supporters include the Association of Private Pension and Welfare Plans, the American Bankers Association, and the American Council of Life Insurers.

Sen. Roth Unveils Prescription Drug Plan

Senate Finance Committee Chairman William V. Roth, J r. (R-DE) July 12 unveiled the outline of a government-run prescription drug plan that would offer drug benefits to all 39 million Medicare beneficiaries, breaking with a private-sector approach favored by House Republicans. While President Clinton welcomed Roth’s proposal, several of Roth’s GOP colleagues said they could not support it in its current form.

Both the Roth and Clinton proposals differ drastically from legislation (H.R. 4680) that House Republicans passed June 28 that would look to the private insurance market to provide drug policies for seniors and subsidize insurers to help finance the benefit. Under Roth’s proposal, the government itself would bear the insurance risks and take responsibility for adminis-
Keeping On Track

**Treasury and Labor Release Joint Policy to Encourage Automatic Enrollment**—Speaking at a July 18 event to celebrate the fifth anniversary of the American Savings Education Council (a program of EBRI-ERF), Secretary of the Treasury Larry Summers announced that Treasury and the Labor Department were releasing a joint policy statement clarifying that both agencies favor automatic enrollment of workers in retirement plans, and find that doing so is in compliance with all ERISA and Internal Revenue Code provisions. The departments made a commitment at the April 2000 Choose to Save Forum on Retirement Savings to provide clarification on this issue (for information on other CTS Forum recommendations, visit www.choosetosave.org). For the statement, go to www.ustreas.gov/press/releases/ps786.htm

**IRS Allows Default Elections in 403(b), 457, and Prototype Plans**—Implementing the new policy announced by Treasury Secretary Summers, the Internal Revenue Service (IRS) issued new guidance to promote retirement savings through automatic enrollment: An employee who fails to return an election form will be deemed to have elected to defer a specified percentage of pay. Such “default elections” are being used in some employers’ 401(k) plans, and the IRS has now authorized their use in Sec. 403(b) plans (Rev. Rul. 2000-35), 457 plans (Rev. Rul. 2000-33) and prototype plans (Announcement 2000-60). In addition, the IRS has approved automatic deferrals up to 4 percent of pay, which is higher than the 3 percent permitted in prior guidance.

**IRS Rules on Default Rollover Method**—The IRS July 14 ruled in Revenue Ruling 2000-36 that a retirement plan may use direct rollovers rather than lump-sum distributions as the default method of paying mandatory distributions of $5,000 or less. Assuming that the plan is properly amended, a mandatory distribution may be rolled directly to an IRA selected by the plan administrator if the participant fails to make an affirmative and timely election to receive cash or direct a rollover to another IRA or retirement plan. The participant must be informed of the default IRA election at least 30 days in advance.

**IRS Issues Final Regulations Increasing Cash-Out Limit**—The IRS July 18 issued final regulations (TD 8891) relating to the increase from $3,500 to $5,000 in the limit on distributions from qualified retirement plans that can be made without spousal consent, as provided for in the 1997 Taxpayer Relief Act. The regulations also eliminate the “lookback rule” under which certain qualified plan benefits are deemed to exceed this limit on involuntary distributions. The final rules are effective Oct. 17, 2000.

**PBGC Seeks Input on Valuing Certain Cash Balance Benefits**—The Pension Benefit Guaranty Corporation (PBGC) is seeking public comments on how the agency should deal with certain valuation issues raised by terminating cash balance plans, pension equity plans, and other hybrid defined benefit plans using variable indices to determine future benefits. The agency is uncertain what assumptions it should make about the future performance of these indices when valuing plan liabilities. Comments are due by Sept. 22, 2000.

**HCFA Issues Guidance on Medicare+Choice Pullout**—Just as Aetna, US Healthcare, Humana, and Oxford Health Plans announced their intention to pull out of the Medicare+Choice (M+C) Program in 2001, the Health Care Financing Administration (HCFA) released guidance summarizing the obligations that withdrawing plans have with respect to participant notification. Among other things, the HCFA guidance requires plans that intend to reduce their service areas or exit the M+C program altogether to notify their members of their intentions by Oct. 2, 2000.

**Recent Court Decisions**

**Courts of Appeals Consider Disclosure Duties to Participants and Beneficiaries**—In two completely different cases, the Third and Sixth U.S. Circuit Courts of Appeals recently held that plan administrators may breach their fiduciary duty under ERISA by failing to provide ERISA participants and beneficiaries with accurate information regarding plan benefits. While both cases were unusual, they support the broader holding by courts that a plan administrator’s duties go beyond simply answering questions accurately. Instead, the plan administrator may have a duty to offer additional information that a participant or beneficiary would find helpful, particularly where the plan administrator’s silence on the issue would be harmful. Palen v. Kmart Corp. (2000 U.S. App. LEXIS 100780, Sixth Cir.) and Harte v. Bethlehem Steel Corp. (2000 U.S. App. LEXIS 12001, Third Cir.).

**Temporary Failure to Invest Plan’s Assets During BlackOut Period Did Not Violate ERISA**—The Seventh Circuit has held that there was no breach of ERISA fiduciary duty when all of a 401(k) plan’s assets were temporarily placed in a money market fund—instead of into individual participant accounts—during a period of about five months while the plan was being spun off into a new 401(k) plan. The court found that it was uncontested that the plan sponsor did not have sufficient information to allow it to invest the funds into individual accounts during the period in question, that investing in a money market fund could not be characterized as irresponsible, and that the employees suffered no damages. King v. National Human Resource Committee, Inc. (2000, CA7, 2000 WL 869589).
tering the benefit, as it does with the rest of Medicare.

Roth’s proposal would develop a new, optional drug benefit that would be administered by private pharmaceutical benefit managers. Beneficiaries who select the new option would have to meet a deductible—possibly $500—before benefits would start. Once drug expenditures hit the still-unspecified level, so-called catastrophic coverage would begin, with the government picking up 80 percent of subsequent costs. Specific premiums and deductibles will be set once the Congressional Budget Office completes its analysis of the plans, but aides say that the Roth proposal will fit within the $40 billion allowed by the Senate budget resolution to finance a prescription drug benefit this year. Roth’s committee was expected to vote on the measure at the end of July.

Church Plan Changes Become Law
President Clinton July 10 signed into law legislation (S. 1309) that exempts church-sponsored health and welfare plans from certain state licensure and solvency rules, including those directed at multi-employer welfare arrangements (MEWAs). However, the new law (P.L. 106-244) indicates that states can continue to enforce other state insurance laws against these plans, including benefit mandates that apply to insurance policies. The measure had been approved in both the House and Senate without objection, so the President’s signature was expected.

Phased Retirement Plan Legislation Introduced
Rep. Earl Pomeroy (D-ND) and Sen. Charles Grassley (R-IA) July 12 introduced identical bills (H.R. 4837, S. 2853) that would allow employers to offer phased retirement programs. Their proposal would amend Sec. 401(a) of the Internal Revenue Code (IRC) and permit employers to provide in-service distributions to their workers when they reach age 59 1/2 or after 30 years of service.

According to Pomeroy, the proposal would not authorize or direct the Treasury and Labor secretaries to draft regulations permitting the maintenance of bona fide phased retirement programs; that issue, and the question of how Congress can encourage employers to offer phased retirement programs, are larger matters that are not specifically addressed in this proposal. Pomeroy is also drafting a separate bill that would remove additional legal hurdles to phased retirement.

EBRI in Focus

EBRI Continues Japanese Cooperation
EBRI President Dallas Salisbury was in Tokyo on July 13–16 for meetings with the Ministry of Health and Welfare, Nempuki (manager of assets of the Japan Social Security system), the Pension Fund Association, and the National Pension Fund Association, on pension reform in Japan and recent experience in the United States with participant-directed investment (based upon the EBRI/ICI 401(k) database) and fiduciary litigation. Salisbury also addressed the third Goldman-Sachs “Tokyo Pension Sponsor Roundtable” on “Pension Governance: The US Experience,” and met with the nine past EBRI Japan Fellows from the Ministry of Health and Welfare. EBRI Japan Fellow Momura Yamashita returned to Japan in July, and Tadayuki Mizutani arrived at EBRI for his year of study.

EBRI Briefing on Fiduciary Liability
EBRI staff held a well-attended educational briefing July 26 on Capitol Hill on the issue of participant investment education, investment advice, and fiduciary liability under the Employee Retirement Income Security Act of 1974 (ERISA). About three dozen congressional staff and Washington representatives of various trade organizations attended the briefing,
which covered the legal and regulatory issues involved when investment advice is provided, focusing in particular on the conditions set forth in the ERISA Sec. 404(c) regulations that would limit plan fiduciary liability, and the Department of Labor’s (DOL) Interpretive Bulletin 96-1 on participant investment education. For more information, contact Teresa Turyn at (202) 775-6353, turyn@ebri.org

Book To Be Published on Spring EBRI-ERF Policy Forum

September will mark the publication of a book on the proceedings of the May 3 EBRI-ERF policy forum on “The Economic Costs of the Uninsured: Implications for Business and Government.” A copy will be distributed to all EBRI members, and additional copies are available for purchase; please contact Alicia Willis at (202) 775-9132 or willis@ebri.org.

ASEC and DOL Labor Host 5th Anniversary Celebration

On July 18, the U.S. Department of Labor (DOL) hosted a Fifth Year Anniversary event to commemorate its Retirement Savings Education Campaign and the creation of the American Savings Education Council (ASEC). The event was an opportunity to recognize a multitude of excellent programs and products undertaken over the past five years to promote savings education and retirement security.

Several new national initiatives were also highlighted, including: a public/private partnership to encourage and help small business owners select a retirement plan; an innovative program that will help low-income workers by teaching them how to manage their finances and achieve savings goals; a new guidance released by DOL that encourages pension plan participation; and the progress of the bipartisan Savings Are Vital to Everyone’s Retirement (SAVER) Act of 1997 and plans for the 2001 White House/Congressional Summit. DOL Secretary Alexis Herman was joined by Secretary of the Treasurer Lawrence Summers, Small Business Administration Administrator Aida Alvarez, EBRI President and ASEC Chairman Dallas Salisbury, and several other public- and private-sector leaders.

EBRI & ASEC Part of Special Retirement Features

With summer come thoughts of vacation—and retirement. That means business and financial magazines and Web sites tend to publish their annual retirement “specials” this time of year, while not working is foremost in the minds of millions of people.

As in previous years, both EBRI and ASEC have been heavily used as resources for these special reports. In this season’s batch, this included mentions in, among others, Fortune (Aug. 14, “Investor’s Guide 2000/Retire Rich”), Money.com (July), Business Week (July 17), U.S. News & World Report (June 5), Barron’s (March 27, “Investing for Retirement” special issue), CNNfn (March, “Retirement Planning”), and the New York Times (Feb 16), as well as the Wall Street Journal’s “Spending It, Investing It” special report on Nov. 29, 1999.

ASEC Participates in Cleveland SEC Investors Town Meeting

ASEC participated in the Securities and Exchange Commission’s (SEC) free Investors Town Meeting on July 25 in Cleveland, OH. ASEC hosted a one-hour, interactive pre-retirement workshop highlighting the Ballpark Estimate worksheet entitled, “Get a Retirement Goal and Choose to Save!” SEC Chairman Arthur Levitt and Treasury Secretary Lawrence Summers also conducted a general session on practical financial tips and answered audience questions. The SEC launched the Town Meeting series in 1994 to promote public understanding of the securities market and awareness of the risks and rewards of investing.

In addition, CNN did a segment on the SEC Town Meeting, featuring Treasury Secretary Summers speaking about the need to save for retirement, and including in the segment two Choose to Save® public service announcements: “The Fly” and “The Magic of Compound Interest.”
New Publications & Internet Sites

[Note: To order publications from the U.S. Government Printing Office (GPO), call (202) 512-1800; to order congressional publications published by GPO, call (202) 512-1808. To order U.S. General Accounting Office (GAO) publications, call (202) 512-6000; to order from the Congressional Budget Office (CBO), call (202) 226-2809].

Employee Benefits


Family Leave
Aon Consulting. The FMLA Guide: Practical Solutions to Administration and Management. $95. (800) 438-6487.

Health Care


Money Management

U.S. Budget

Documents Available on the Internet
401(k) Plan Participants: Characteristics, Contributions, and Account Activity
www.ici.org/pdf/
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What we do

EBRI’s work advances knowledge and understanding of employee benefits and their importance to the nation’s economy among policymakers, the news media, and the public. It does this by conducting and publishing policy research, analysis, and special reports on employee benefits issues; holding educational briefings for EBRI members, congressional and federal agency staff, and the news media; and sponsoring public opinion surveys on employee benefit issues. **EBRI’s Education and Research Fund** (EBRI-ERF) performs the charitable, educational, and scientific functions of the Institute. EBRI-ERF is a tax-exempt organization supported by contributions and grants. The **American Savings Education Council** (ASEC), part of EBRI-ERF, is a coalition of private- and public-sector institutions with the goal of making saving and retirement planning a vital concern of all Americans.

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**EBRI Issue Briefs** are monthly periodicals providing expert evaluations of employee benefit issues and trends, as well as critical analyses of employee benefit policies and proposals. **EBRI Notes** is a monthly periodical providing current information on a variety of employee benefit topics. **EBRI’s Pension Investment Report** provides detailed financial information on the universe of defined benefit, defined contribution, and 401(k) plans. **EBRI Fundamentals of Employee Benefit Programs** offers a straightforward, basic explanation of employee benefit programs in the private and public sectors. **EBRI Databook on Employee Benefits** is a statistical reference volume on employee benefit programs and work force related issues.

Subscriptions/orders

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