



Statement On

DISTRIBUTION AND ECONOMICS OF EMPLOYER PROVIDED FRINGE BENEFITS

Before the United States House of Representatives
Committee on Ways and Means
Subcommittees on Social Security and Select Revenue Measures

September 18, 1984

of

Dallas L. Salisbury*
President
Employee Benefit Research Institute

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

Dallas Salisbury is President of the Employee Benefit Research Institute, a non-profit, non-partisan, public policy research organization. Before joining EBRI he served in senior career policy research positions at the U.S. Department of Labor and the U.S. Pension Benefit Guaranty Corporation. This statement draws heavily from research studies conducted, published, and copyrighted by EBRI.

Summary

- Retirement, health, life, and disability benefits are widespread, with between 70 percent and 83 percent of full time workers over the age of 25 covered.
- Nationally an average of 4.6 percent of wages and salaries is spent on voluntary tax exempt benefits and 4.0 percent on tax-deferred benefits.
- These benefits are provided across the salary range, with most going to middle-income households. Over 75 percent of those with coverage earned less than \$25,000 in 1982.
- Studies by the Treasury and by private economists indicate that benefits enhance tax equity and that taxation of benefits would have the most adverse effect on the lowest earners.
- FICA taxes could be lowered if benefits were subject to FICA tax. As the maximum taxable wage base rises, the rate could be decreased as well. Current government estimates overstate the amount, however, because of the assumption that benefits will continue to grow until all compensation is paid as benefits.
- Econometric studies indicate that taxation of benefits would lead to reduced availability, but the exact extent cannot be established. Further, it is impossible to assess how much higher direct expenditures might have to be to accommodate these cutbacks.
- Imposition of limits or caps that would "prevent further erosion of the tax bases" would (a) mean that no organizations without programs today could establish them or (b) that all employers now with programs would have to pay tax on some portion in order to allow expansion room. Some employers and employees would have to begin paying tax on more than 20 percent of wages and salaries now paid in the form of benefits out of current earnings.
- Employer-provided benefits complement social programs, help to maintain public confidence in them, reduce demands placed upon them, and strengthen the economy in the process. Employer retirement plan benefit payments in 1983 exceeded the government calculated tax expenditure by \$37 billion and health benefit payments by \$60 billion. And costs per covered participant were far below the per participant expense of social programs.
- Employer-provided benefit programs and social programs appear to be an effective partnership. Each provides for particular segments of the population in an effective manner. Each adds to economic security. There are some programs that do not meet this test. During this time of limited resources, they should be reconsidered.

Statement

Mr. Chairman, I am pleased to appear before the Committee today to discuss employee benefits. Following these hearings I would look forward to an opportunity to provide additional assistance to the Committee.

The Committee is to be commended for holding this exploratory hearing into employee benefits and the tax code. The general tax treatment of employee benefit programs has been relatively consistent over time, with health insurance being tax exempt and retirement and capital accumulation programs being tax deferred. The tax treatment of fringe benefits is in transition, with additional "sunsets" ahead. Nearly all current American workers have experienced the present tax treatment of primary benefits for their entire careers. These workers have come to take the presence of social and employer-provided employee benefits for granted: including the current tax treatment of primary employer provided benefits.

Tax laws favoring specific employer retirement and health insurance plans and other statutory employee benefits were enacted under the premise that extensive coverage of workers and their dependents under these plans is desirable social policy. Numerous research studies have documented the fact that these employer based programs complement Social Security and Medicare and reduce long-term demands on these social programs. Further, as I will document, they complement the design of these programs.

The press release announcing this hearing asked a number of specific questions that I will attempt to answer for the Committee. First, how prevalent are employee benefit and fringe benefit programs, and how does this compare to the past?

Chart 1 provides information on prevalence for the primary benefits of retirement, life, health, sickness, and disability for medium and large firms among full-time workers. Health, life, and disability programs are provided to between 90 and 95 percent of these full-time workers and retirement programs to 82 percent. Information is not collected on the fringe benefits (education, legal, van pool) because very small numbers of employees are covered by these programs.

Not all workers are with medium and large firms, however, so we must also look at the total civilian work force. Data collected by the Bureau of the Census in May 1983 for EBRI and the U.S. Department of Health and Human Services provides this information for retirement and health programs.

Chart 2 and Table 1 show that retirement and health programs are prevalent, particularly among those working over 1,000 hours per year. Among full-time employees over the age of 25, 70.01 percent are covered by a pension and 36.84 percent currently are entitled to a vested benefit. Of all civilian workers age 14 to 64, 52.07 percent are covered and 24.35 percent are entitled to a vested benefit. Health insurance is also more readily available to full-time workers, with 83.07 percent having primary coverage compared to 59.66 percent of all civilian workers.

Retirement program and health insurance coverage have grown significantly in absolute terms, but remained relatively constant in percentage terms over the past ten years.

Second, how much do benefits represent as a percentage of compensation?

According to Chamber of Commerce data, presented in Chart 3 and Table 2, employer contributions to tax-exempt and tax-deferred employee benefits totaled 9.0 percent of wages and salaries in 1982.

Employer contributions to tax-favored benefits--those that are not taxed as current income to the employee--can be divided into two groups: benefits on which taxes are deferred and benefits that are tax exempt.

- Tax-deferred benefits include primarily employer contributions to retirement income and capital accumulation plans. These constituted about 4.0 percent of wages and salaries in 1982. Taxation of these benefits is deferred until the employee withdraws funds from the plan.
- Tax-exempt benefits include employer contributions to group health insurance and a variety of smaller benefits that include dental insurance, child care, merchandise discounts, and employer-provided meals. These benefits constituted 4.6 percent of wages and salaries in 1982.

Failure to distinguish among the growth of legally required employer payments, fully taxable employee benefits, tax-deferred benefits, and tax-exempt benefits has greatly distorted the perception of the tax-base erosion that can be attributed to tax-favored and tax-exempt benefits.

Third, how much have tax-favored employee benefit costs grown?

Over the past thirty years, tax-favored employee benefits have grown more rapidly than wages and salaries and slightly faster than either legally required employer payments or fully taxable employee benefits. Consequently, tax-favored benefits have absorbed a rising share of total compensation. Chart 4 and Table 3 show that pension and profit sharing contributions grew significantly in the post ERISA period, and health care cost inflation felt by employer and social programs doubled expenditures for group health insurance. The recent slower growth of employer pension contributions appears to be likely to continue, according to the most recent employer surveys. The slower

growth between 1980 and 1982 of employer health insurance contributions as a share of total compensation may reflect the maturation of group health coverage and benefits, as well as employer efforts to contain the cost of private health insurance plans.

"Fringe" benefit expenditures have not increased significantly over this 30 year period. Government data shows that expenditures are less than .5 percent of wages and salaries.

Fourth, how much do costs vary by industry?

The cost of discretionary employee benefits varies significantly from employer to employer, even within industries. Further, there is significant variation among industries. During 1982 total average expense ranged from 12.5 to 29.0 percent of total compensation among Fortune 500 firms. The expenditure would be lower for very young and small businesses. Chart 5 and Table 4 present data for the Fortune 500 for twelve different industry groups. It documents significant variation in expenditures for voluntary tax-exempt and tax-deferred employee benefits.

Fifth, what is expected to happen in the future?

Retirement program and health insurance coverage may well be at a plateau for the near term. For retirement programs, benefit receipt will continue to grow as the system continues to mature, but there are structural questions that need to be explored.

Employee benefit cost rate growth is likely to continue to slow. Employer contributions to retirement programs are expected to decline by 15 percent in 1984 as more plans reach the point of full funding. Health cost inflation is down significantly, which will hold down premium growth. Additionally, employers are moving on many fronts to control health care expenditures today

and in the future. Surveys of employers indicate that a changing work force, changing industry structure, and international competition, are combining to put an effective lid on excessive future employee benefit growth.

Employee expenditures on a tax-favored basis, however, are expected to continue to grow. These "salary reduction" features were a part of the Revenue Act of 1978. And contributions to Individual Retirement Accounts (IRAs) are expected to continue to grow also.

Expenditures on all other employee and fringe benefits combined are small, as shown by Chart 3 and Table 2, and these expenditures are not expected to grow significantly.

Sixth, which employees by salary range receive employee benefits?

Primary benefits are broadly distributed across the income spectrum. Charts 6 and 7 and Table 5 show that nearly 83 percent of all nonagricultural wage and salary workers earn less than \$25,000 per year. Pension coverage and vesting follow this pattern with 76 percent of those covered earning less than \$25,000 and 70 percent of those vested earning less than \$25,000. The table also shows that while the proportion of those earning over \$50,000 participating in a retirement program is high, these persons represent only 2.89 percent of all pension participants.

Growth of employer group health insurance coverage among workers and their dependents has promoted wide access to health care throughout the population. Health insurance is the most common benefit offered employees in the United States. Charts 8 and 9 and Table 6 show that in 1982 health insurance enjoyed a broad distribution across the income spectrum. Those earning less than \$25,000 constituted 80.1 percent of those with health insurance protection.

Other employee and fringe benefits now, as a matter of law, have to be provided on a non-discriminatory basis. While data is not available, this requirement likely means that distributions are similar.

Seventh, how does employee benefit provision vary by industry?

Retirement program coverage, as shown in Chart 10 and Table 7, varies considerably by industry. The lowest coverage levels are found in construction, retail trade, and business and professional services. The highest levels are in the chemical, primary metals, and public employment areas.

Chart 10 and Table 7 indicate that health insurance provision is more consistent across industries, but that variation does exist. Rates of over 97 percent are found in primary metals, automobiles, chemicals, and communications, while business and personal services firms provide for 59.92 percent. Health insurance is generally the first benefit employers provide.

Eighth, what are the economic effects of tax incentives for benefits and what effects would changes in tax treatment have?

A number of studies have been done to assess horizontal and vertical equity of the tax provisions. The Treasury Department conducted such a study in 1982. The results of that study are confirmed by a just completed study by economist Sophie Korczyk. Chart 11 and Table 8 show that the tax value of employee benefit incentives parallels tax payments, with low income persons getting more of the value of the tax reductions than their share of tax payments and the highest paid getting less. In other words, a change in the tax treatment of benefits would lead to a regressive result. More recent studies by economists Deborah Chollet and Sophie Korczyk confirmed these findings, as did a CBO analysis of the health care tax cap proposal published in 1983.

Private retirement program tax expenditures form the single largest category of tax expenditures in the federal budget. They arise from the deferral of taxes paid on: (1) pension and retirement saving contributions and (2) earnings on these contributions. The dollar value of the tax expenditure demands that equity and efficiency questions be explored (see Appendix II for a brief discussion of the tax expenditures). A major new study by Sophie Korczyk assesses these incentives in a lifetime context. She finds that the economic value to the government is significantly greater than looking at tax expenditure numbers alone would imply. As much as 72 percent of the real (i.e., inflation-adjusted) value of taxes deferred during the pension participants' working career is ultimately repaid as income tax during retirement.

Chart 12 and Table 9 show that Treasury tax expenditure statistics, calculated on a cash-flow basis, leave the impression that the proportion of current tax deferrals permanently lost to the Treasury is very large. Treasury statistics imply that 83 cents out of every deferred dollar is permanently lost, with the other 17 cents accounted for by current tax payments by retirees. When examined in a lifetime context, the proportion of deferred taxes lost to the Treasury ranges from 14 cents out of every dollar to 40 cents, depending on whether or not one adjusts for inflation and interest on deferred taxes and the interest factor used.

One factor that has not generally been considered in discussing changes in the tax treatment of employee benefits, however, that could involve a significant shift in the incidence of the income tax is the increasing cost, and therefore value of benefits, as workers age. This would represent a major effect of tax policy change.

Employee benefits such as defined-benefit pensions and health insurance are almost always discussed as a flat dollar cost per employee or as a level percentage of pay per employee. Employee representatives, employees, and employers have been content with this approach since the actual distribution of cost does not affect either the taxes to be paid by the employee or the employer. As a result, the only attention given to date to actual per employee cost variation has been undertaken very recently to assess: (1) approaches to health care cost containment and (2) possible disincentives to hiring or keeping on older workers. These recent studies show very significant cost variation by age (Chart 13 and Table 10).

Does this cost variation make a tax policy difference? The answer will be yes if employee benefits were to be subjected to income tax or FICA tax. Employees would come to recognize the inequity involved in paying taxes without reference to the true economic value of the benefit being provided. This could lead to demands for taxing based upon the actual dollar value of the benefit provided or a move to tax the benefits paid instead of the premium. This would require a total restructuring of the way in which benefit programs are run.

Present approaches to health insurance pricing and delivery were developed in the present tax environment. A major change in that environment will have a major affect on those approaches and structures. Nearly all of the government and academic research done on this subject to date assumes that a change in tax policy will not change the method of providing or pricing benefits.

Finally, econometric estimates of private health insurance suggest that significant numbers of persons now covered would not choose to purchase health

insurance if it was not available from an employer and largely paid for by the employer.

Tenth, what levels or limits would have to be placed on benefit expenditures to prevent further tax base erosion?

Meeting the objective of avoiding any further tax base erosion from employee benefit and fringe benefit expenditures could be achieved in a number of ways, but none would be simple.

1. FICA

- a. Any expenditures beyond those now being made would be subject to FICA tax. This would mean that on average expenditures above 9 percent of wages and salaries would be subject to FICA. But it would also mean that any new plans established would be subject to FICA beginning with the first dollar of expenditure.
- b. Any expenditures beyond the current national average would be subject to FICA. Table 4 shows that this would require some employers and employees to begin paying FICA on more than 20 percent of wages and salaries where it is not now paid. To avoid any further erosion, any organization putting in a plan for the first time would pay FICA on every dollar.
- c. Any expenditures above 5 percent of wages and salary would be subject to FICA. This would require almost all organizations with benefit programs to pay FICA on some portion of their current expenditures (some on 24 percent of wages and salaries--or more) but would allow room for new organizations to establish programs.

Under present law organizations can spend 15 percent of compensation on retirement programs, and last year the value of the federal civil service

pension contribution was over 27 percent. Health, life, and disability add more. This would mean very significant employee tax payments out of current income.

2. Income Tax

The same alternatives are available. In the income tax area as well, a goal of "no further erosion" would lead to inequities and to major individual worker and organizational transitions. Table 2 shows the average level above which contributions would have to be taxable, and Table 4 shows how such caps would affect different industries.

Finally, what is the relationship of employer sponsored benefits to social programs?

Social Security, employer-sponsored pensions, and IRAs are complementary, working together to assure retirement incomes. They are not perfect substitutes in terms of benefit delivery, but change in one would effect public pressures for, support for, and confidence in the others.

Social Security provides a floor of protection on a redistributational basis, with lower earners receiving proportionally greater benefits. Many of those who rely most heavily on Social Security do not have high enough incomes to allow savings, and their work is such that they are unlikely to have employer-sponsored retirement plans. Social Security is a pay-as-you-go program. Research indicates that it has no effect, or a negative effect, on aggregate national savings.

Employer-sponsored plans provide another form of "forced" savings that represents a tier of income above Social Security. Among employers with more than 250 employees, these programs are almost universal. Among smaller employers they are not. For a significant portion of the population these

advance funded programs represent their only real savings. As a result, research indicates that each dollar contributed to a pension increases aggregate national savings by at least 35 cents.

IRAs are a vehicle for voluntary savings. They are used by 17 million persons as compared to over 50 million with pension coverage. Over 13 million IRA holders also have pension coverage.

There are also differences in what these programs provide, or must provide, under current law. These differences affect the degree to which employer-sponsored plans and IRAs "complement" Social Security in terms of retirement income provision.

Social Security only pays benefits as a stream of monthly benefits.

Employer-sponsored plans are of two types: (1) those that only pay benefits as a stream of monthly benefits--most defined-benefit plans and some defined-contribution plans such as TIAA-CREF and (2) those that make one time "lump-sum" payments at change of employment or at retirement age and thus may or may not produce retirement income--most defined-contribution plans.

IRAs allow the money to be withdrawn at any time with the payment of a small penalty and after age 59 and 1/2 allow it to be removed as a lump-sum.

Employer-sponsored health programs provide risk protection to most workers and their dependents. Research indicates that taxation of these programs might lead to a reduction in coverage. This in turn could produce significant pressure for a government program to complement present health programs for the poor (Medicaid) and the elderly (Medicare). Employers also increasingly are providing health insurance for retirees to supplement Medicare. Were these programs eliminated it could increase long-term costs of Medicare due to a reduction in wellness.

In 1983 health insurance, according to the Treasury, represented a tax expenditure of approximately \$17 billion. This financed approximately \$77 billion in benefit payments. In 1983 employer-sponsored retirement programs represented a tax expenditure of approximately \$50 billion. This financed approximately \$87 billion in retirement benefits paid in 1983. Numerous research studies have been undertaken to assess the degree to which contributions to retirement programs, over \$100 billion in 1983, add to national savings. The most pessimistic of these studies concludes that there is a 35 percent addition, or \$35 billion in 1983.

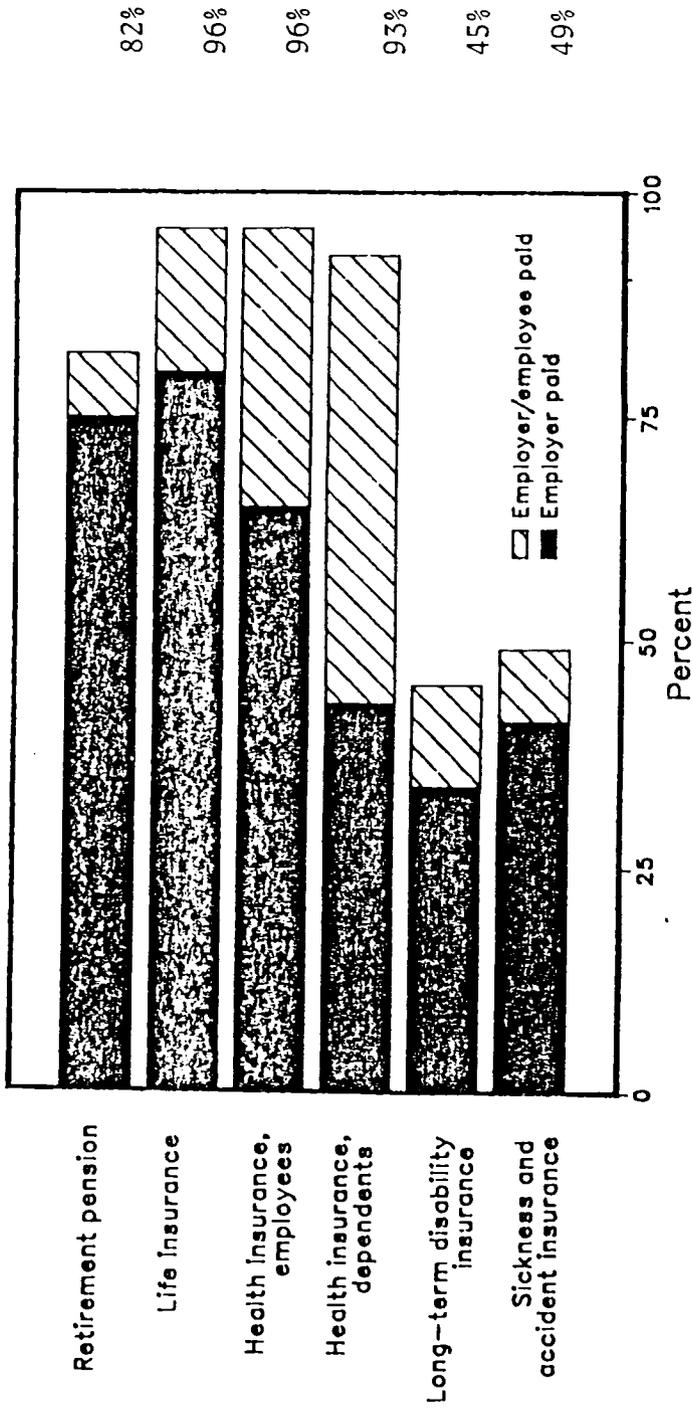
Proposals for tax reform, therefore, need to be carefully scrutinized. To the degree the full taxation of these programs as income rests on the assumption that they will continue to exist, research indicates that for millions of workers they will not. Further, taxation could lead to an unintended age discrimination effect if health insurance were given an income value equal to the benefit provided, which would increase dramatically with age.

Conclusion

During a time when there are no apparent limits on direct federal expenditures, or on "tax incentives," analysis may not need to focus on the diversity of employee benefits. During a time of apparent limitations, however, when priorities must be decided upon, careful analysis is required of each employee benefit and why each employee benefit exists. You are to be commended for undertaking this review effort. I would welcome the opportunity to be of additional assistance in the future. Thank you.

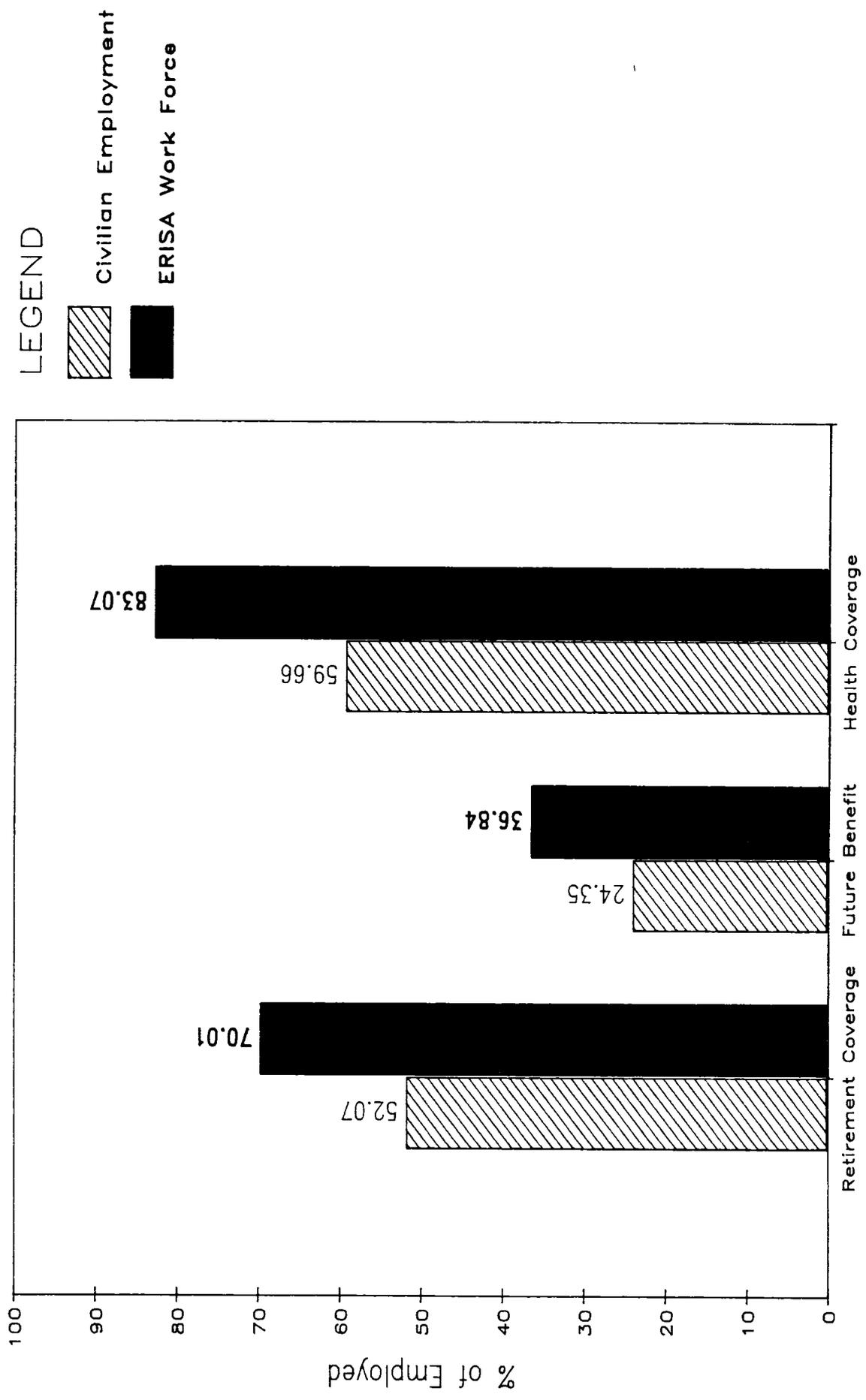
Chart 1

Insurance and pension plans: Percent of full-time employees covered, medium and large firms, 1983



SOURCE: U.S. Department of Labor, Bureau of Labor Statistics, Employee Benefits in Medium and Large Firms, 1983, Bulletin 2213 (Washington, DC: U.S. Government Printing Office, August 1984).

Chart 2 Prevalence of Employee Benefits



Source: Employee Benefit Research Institute

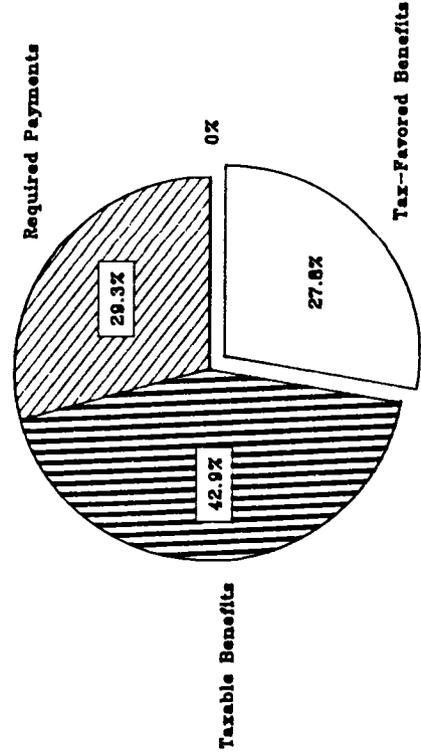
Table 1

Employment, Retirement Program Coverage, Future Benefit Entitlement,
and Primary Health Insurance Coverage, May 1983

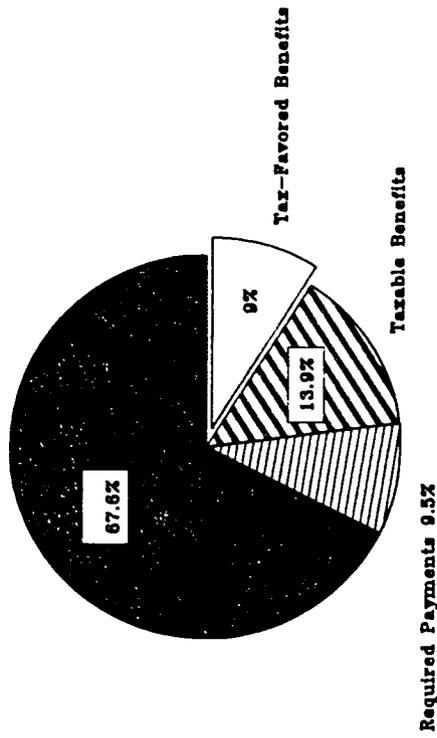
	Employment	Retirement Coverage	Future Benefit Entitlement	Primary Health Insurance Coverage
	(000's and % of Employed)			
Civilian Employment	98,964	51,530	24,095	59,041
(All employees & self- employed)	100.00%	52.07%	24.35%	59.66%
ERISA Work Force	54,363	38,057	20,027	45,161
(age 25 to 64, working 1000 hours or more, one year of tenure or more)	100.00%	70.01%	36.84%	83.07%

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983
EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

Chart 3 Composition of Employee Benefits



Percentage of All Benefits



Percentage of Wages and Salaries

Table 2

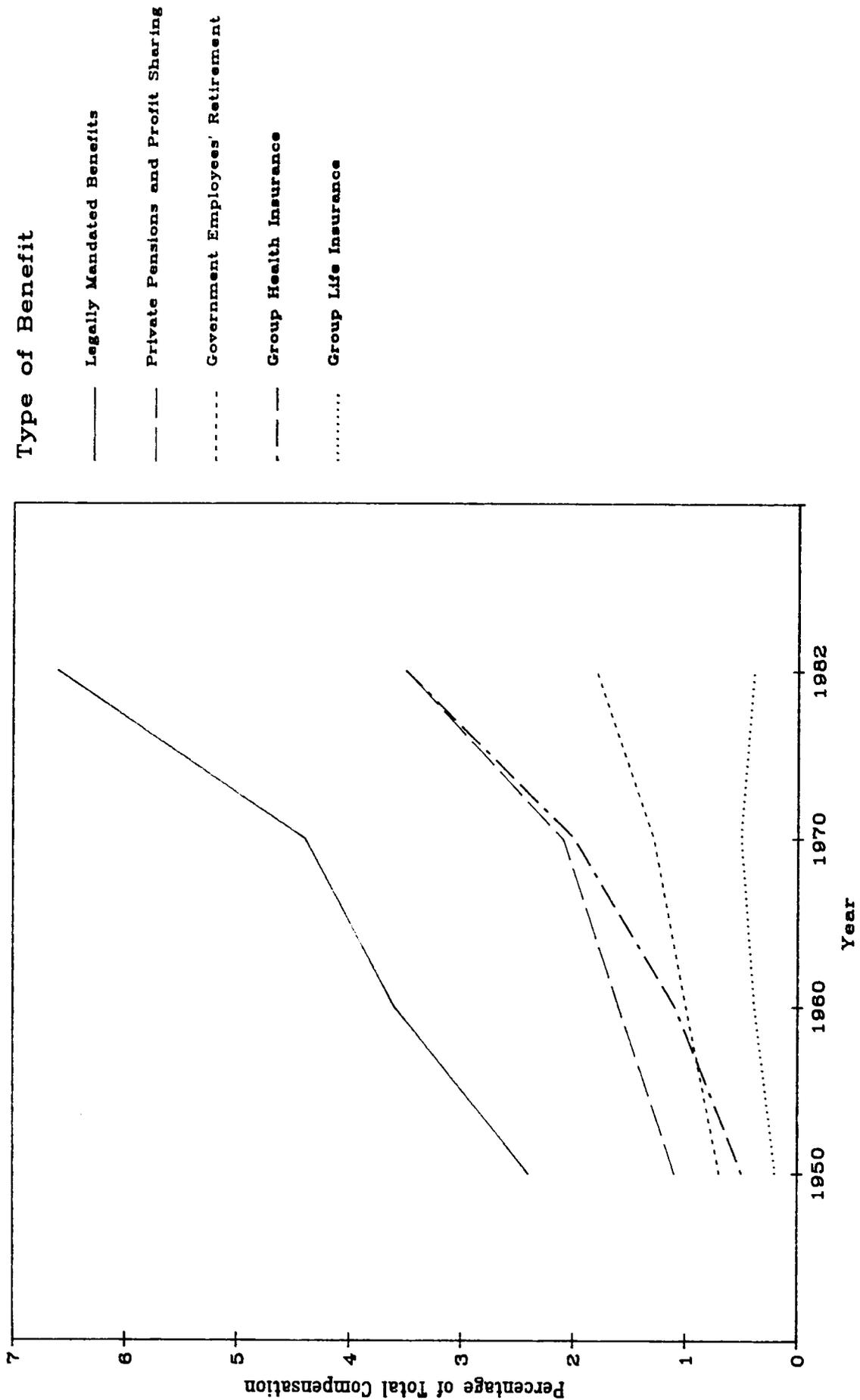
Composition of Employee Benefits by Benefit Group, 1982

Benefit Group	Employer Payments as a Percentage of Wages and Salaries	Employer Payments as a Percentage of All Benefits
<u>Total Benefit Payments</u>	<u>32.5</u>	<u>100.0</u>
<u>Legally Required Employer Payments:</u>	<u>9.5</u>	<u>29.2</u>
Social Security (FICA)	5.2	16.0
Unemployment Compensation	1.1	3.4
Workers' Compensation	0.9	2.8
Other Legally Required Payments <u>a/</u>	2.3	7.1
<u>Discretionary Taxable Benefits:</u>	<u>13.9</u>	<u>42.8</u>
Time not worked <u>b/</u>	9.8	30.2
Rest Periods	3.8	11.7
Other Taxable Benefits <u>c/</u>	0.3	0.9
<u>Discretionary Tax-Favored Benefits:</u>	<u>9.0</u>	<u>27.7</u>
Contributions to pension and Profit-Sharing Plans <u>d/</u>	4.0	12.3
Group Health, Life, Short-Term Disability Insurance	4.4	13.5
Other Tax-Favored Benefits <u>e/</u>	0.6	1.8
<u>Summary:</u>		
Legally Required Employer Payments and Discretionary Taxable Benefits	23.5	72.0
All Discretionary Benefits	23.0	61.5
Fully Taxable Benefits	13.9	42.8
Tax-Favored Benefits	9.0	27.7

SOURCE: EBRI tabulations of estimates produced by the U.S. Chamber of Commerce, Employee Benefits 1982 (1983), pp. 11 and 28.

- a/ Includes government employee retirement, Railroad Retirement Tax, Railroad Unemployment and Cash Sickness Insurance, and state sickness benefits insurance.
- b/ Includes paid vacations and payments in lieu of vacation; payments for holidays not worked; paid sick leave; payments for State or National Guard duty; jury, witness, and voting pay allowances; and payments for time lost because of death in family or other personal reasons.
- c/ EBRI estimate based on Chamber of Commerce report of amount of Christmas or other special bonuses, service awards, suggestions awards, special wage payments ordered by courts, and payments to union stewards.
- d/ EBRI estimate of Chamber of Commerce report of employer contributions to profit-sharing plans.
- e/ EBRI estimate of Chamber of Commerce report of employer-paid dental premiums, merchandise discounts, employee meals furnished by company, payments for vision care and prescription drugs, moving expenses, and contributions to employee thrift plans and employee education expenditures. Tax-preferred benefits are overstated by the amount of separation or termination pay received by employees but not distinguishable from other tax-favored benefits in the Chamber of Commerce estimates.

Chart 4 Employee Benefits Growth 1950 - 1982



Source: Employee Benefit Research Institute

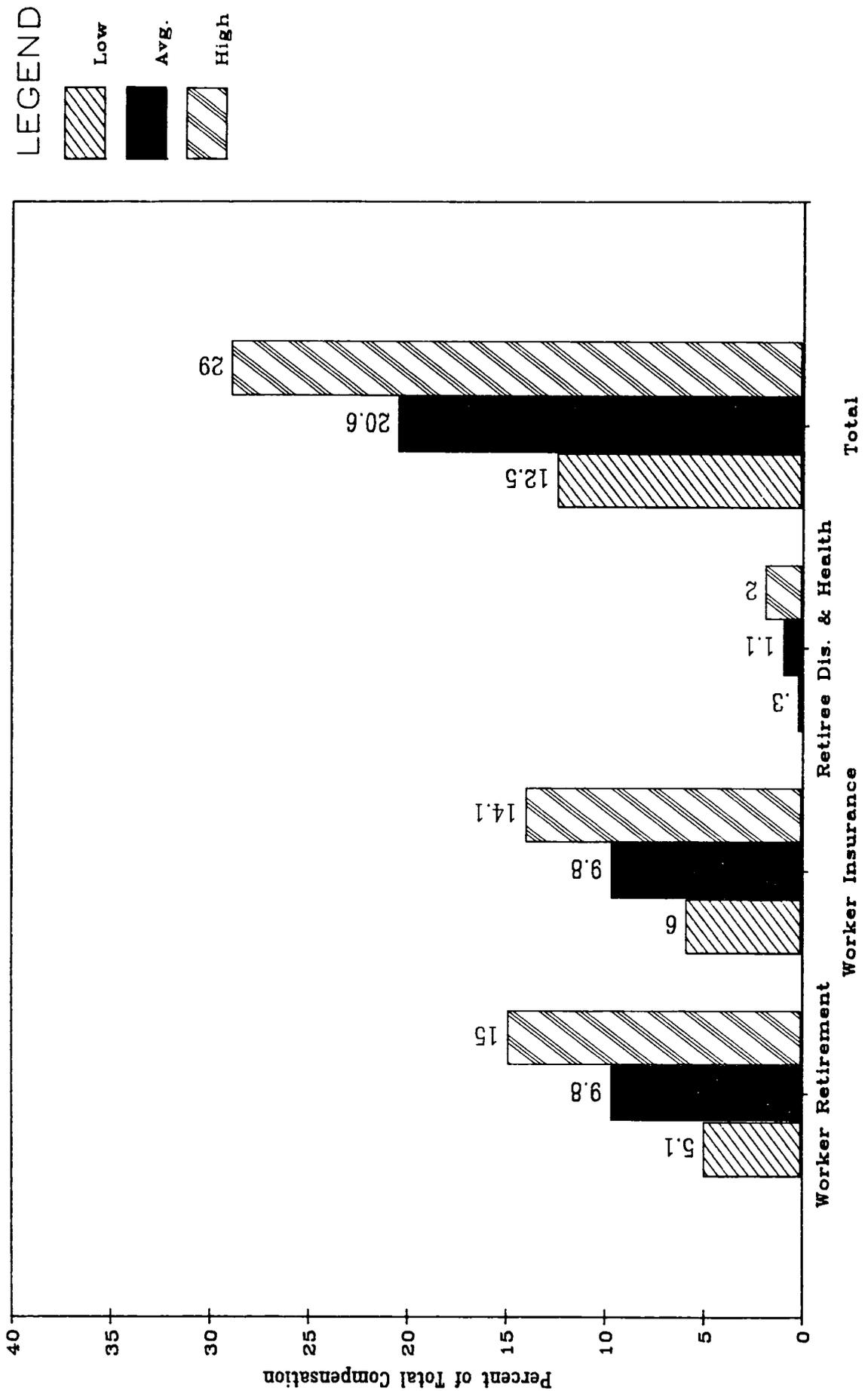
Table 3

**Employer Outlays for Employee Benefits in the National Income and Product
Accounts for Selected Years, 1950-1982**

Type of Benefit	1950		1960		1970		1982	
	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)	Amount (Billions)	Total Compensation (Percent)
Legally mandated benefits								
Social Security Old-Age Survivors and Disability Insurance	\$1.3	0.8	\$5.6	1.9	\$16.2	2.6	\$69.2	3.7
Social Security Hospital Insurance	a	a	a	a	2.3	0.4	16.4	0.9
Unemployment Insurance	1.5	1.0	2.8	1.0	3.5	0.6	17.4	0.9
Worker's Compensation	<u>1.0</u>	<u>0.6</u>	<u>1.9</u>	<u>0.7</u>	<u>4.7</u>	<u>0.8</u>	<u>19.9</u>	<u>1.1</u>
Total	\$3.8	2.4	\$10.3	3.6	\$26.7	4.4	\$122.9	6.6
Voluntary benefits								
Private pensions and profit-sharing	1.7	1.1	4.9	1.6	13.1	2.1	65.2	3.5
Federal, state, and local government employees' retirement plans	1.1	0.7	2.9	1.0	7.8	1.3	33.8	1.8
Group health insurance	0.7	0.5	3.4	1.1	12.1	2.0	65.7	3.5
Group life insurance	0.3	0.2	1.1	0.4	2.9	0.5	7.2	0.4

SOURCE: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, (1984)).

Chart 5 Employee Benefits Cost Variation



Source: Employee Benefit Research Institute

Table 4

Low, Average and High Employer Contributions to Discretionary
Employee Benefits as a Percent of Total Compensation, 1982

Industrial Classifications ^{1/}	Total Worker Retirement ^{2/}			Total Worker Insurance Benefits ^{3/}			Total Retiree Dis. & Health ^{4/}			Grand Total		
	Low	Avg.	High	Low	Avg.	High	Low	Avg.	High	Low	Avg.	High
Petroleum & Refining	8.6	11.2	13.9	6.9	9.0	11.2	.7	.9	1.1	16.2	21.1	26.2
Electronics (Appliances)	6.0	7.6	9.2	7.2	9.0	10.9	.5	.6	.7	13.8	17.2	20.8
Office Equipment (includes computers)	5.1	6.5	7.7	7.6	9.6	11.3	.6	.7	.8	13.3	16.8	19.8
Industrial and Farm Equipment	7.5	9.7	13.6	7.8	10.1	14.1	.7	.9	1.3	15.9	20.7	29.0
Pharmaceuticals	7.4	8.8	9.8	8.1	9.7	10.8	.8	.9	1.0	16.3	19.4	21.5
Chemicals	10.1	11.6	15.0	8.5	9.8	12.6	.8	.9	1.2	19.4	22.3	28.8
Paper, Fiber and Wood Products	7.5	9.2	10.3	8.0	9.9	11.1	.9	1.1	1.2	16.4	20.2	22.6
Food	8.3	10.0	11.6	8.2	9.9	11.5	.7	.9	1.0	17.3	20.8	24.1
Utilities	7.4	10.1	12.6	6.9	9.5	11.9	1.1	1.5	1.9	15.4	21.1	26.4
Life Insurance	8.1	12.5	15.0	6.0	9.1	11.1	1.0	1.6	2.0	15.1	23.2	28.3
Banks	11.4	13.9	15.0	7.2	8.8	10.0	.7	.8	.9	19.3	23.5	26.8
Retailing	6.0	7.1	7.8	6.2	7.4	8.1	.3	.4	.4	12.5	14.9	16.4
<u>Fortune 500</u>	5.1	9.8	15.0	6.0	9.8	14.1	.3	1.1	2.0	12.5	20.6	29.0

Source: EBRI calculations of data provided by Hewitt Associates.

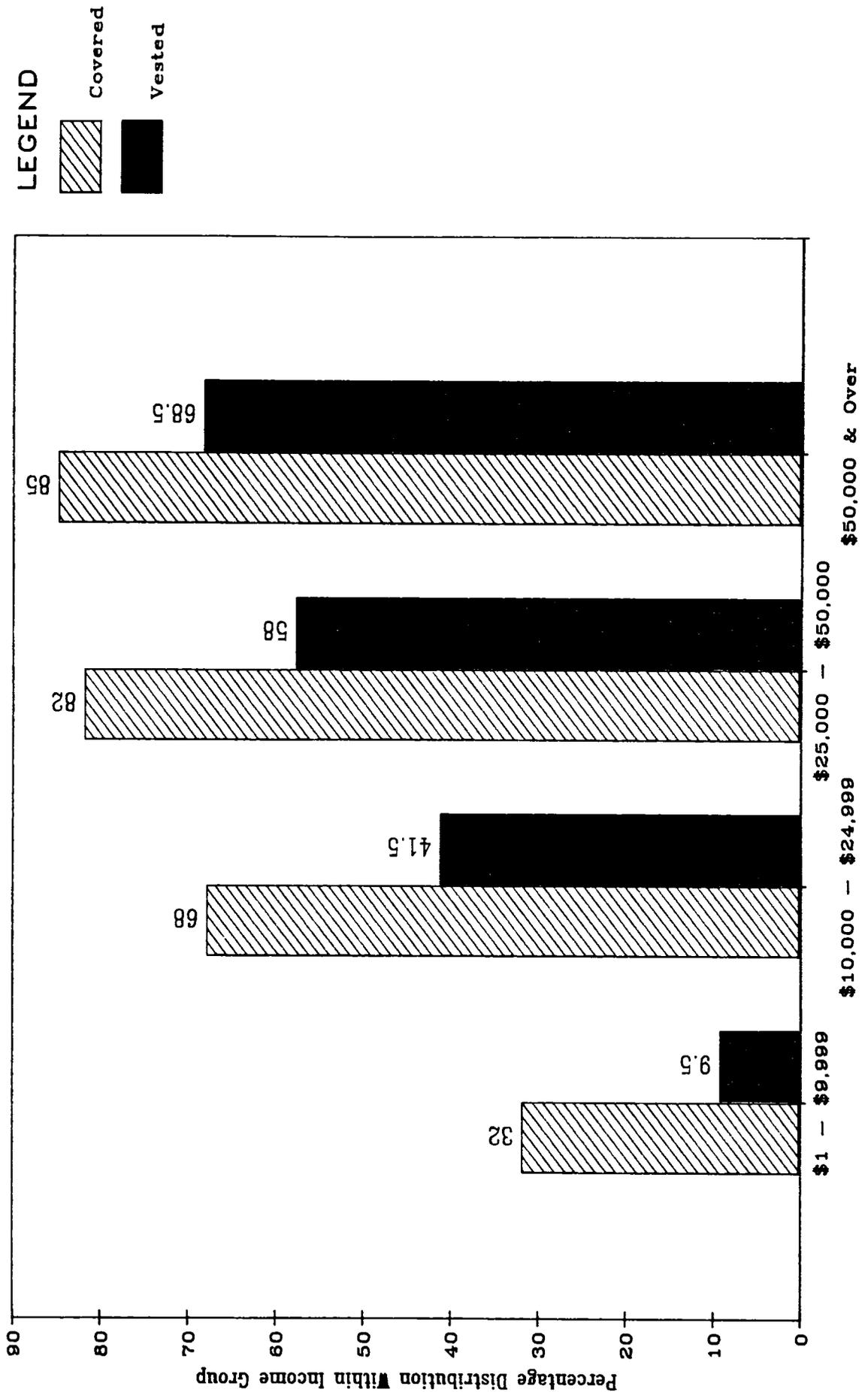
^{1/} Based on Fortune magazine's industrial classifications.

^{2/} Total worker retirement includes employer contributions to defined benefit and defined contribution pension plans, and profit sharing plans.

^{3/} Total worker insurance benefits includes employer outlays to group life and survivor plans, long- and short-term disability plans, and health insurance (including medical, dental and vision plans).

^{4/} Total retiree disability and health includes employer contributions to health insurance and disability income for retirees.

Chart 6 Pensions by Earnings

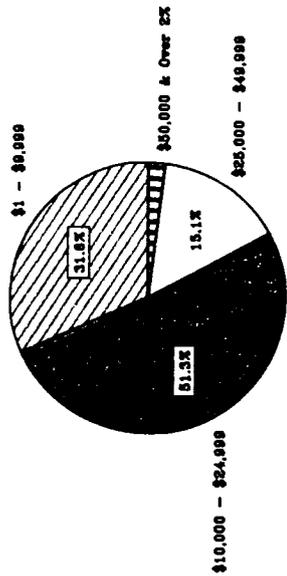


Source: Employee Benefit Research Institute

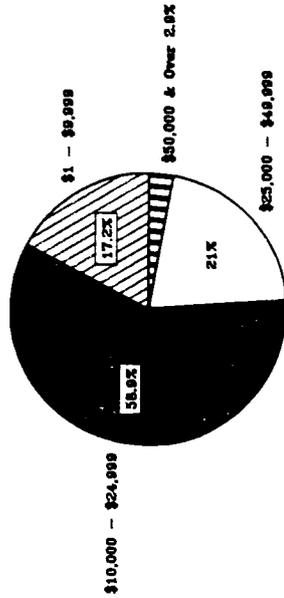
Chart 7

Pensions by Earnings

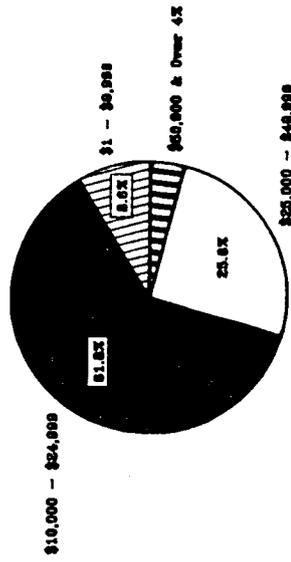
Percentage Distribution Across Income Groups



Employment



Coverage



Vesting

Table 5

Employment Coverage and Vesting:
Distribution by Earnings for
Nonagricultural Wage and Salary Workers, May 1983

Earnings	Number of Workers (000's)*		
	Employment	Coverage	Total Vested Benefits
Total	80,289	47,372	27,603
\$1-4,999	10,014	2,433	358
\$5,000-9,999	15,323	5,747	2,023
\$10,000-14,999	17,827	10,328	5,484
\$15,000-19,999	13,101	9,422	5,874
\$20,000-24,999	10,283	8,159	5,641
\$25,000-29,999	5,515	4,365	3,048
\$30,000-50,000	6,611	5,547	4,072
\$50,000 and over	1,615	1,371	1,106

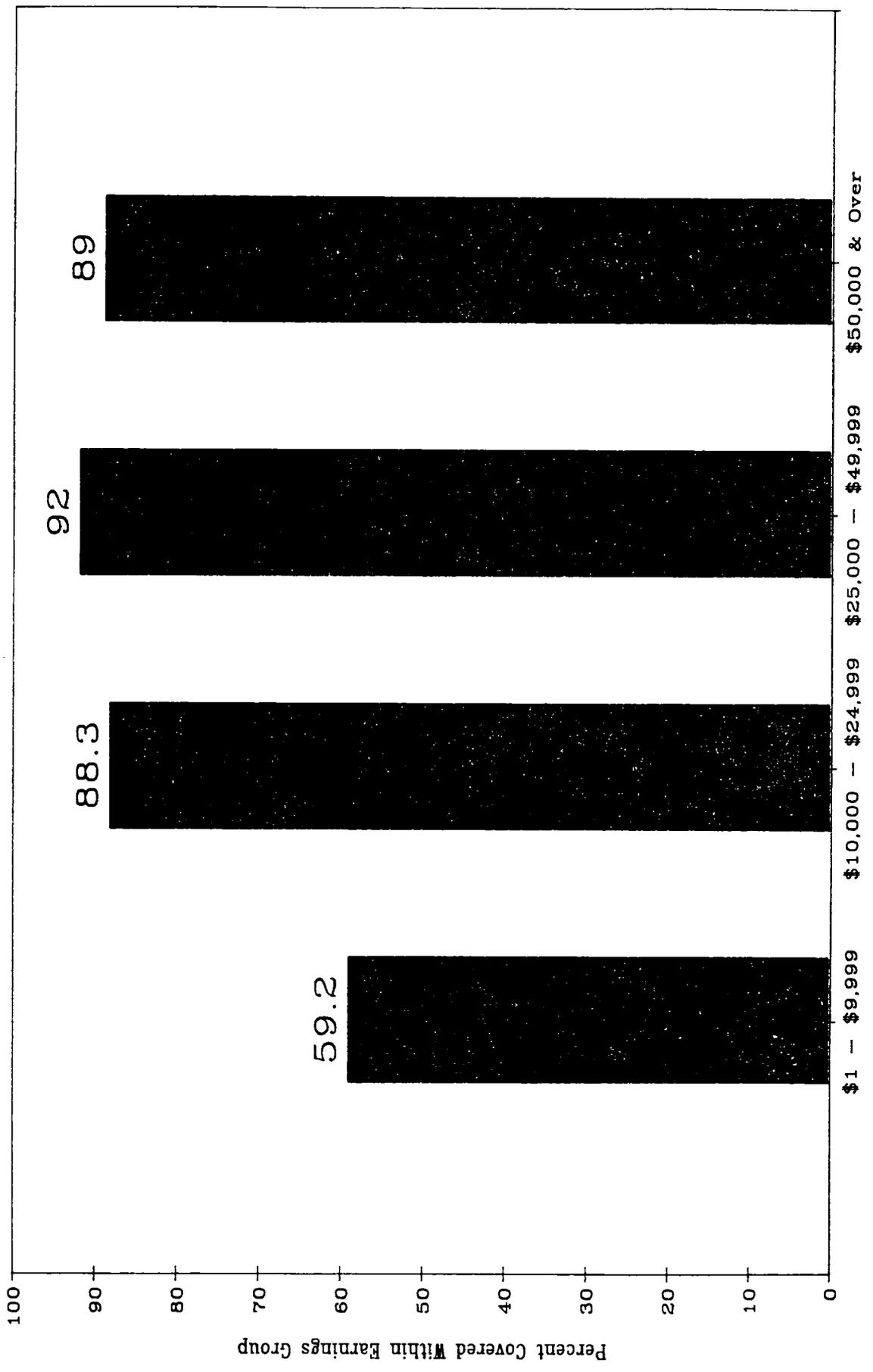
	Percentage Distribution Within Income Group		
	Employment	% Covered to Employed	% Vested to Employed
Total	100.00%	59.00%	34.38%
\$1-4,999	100.00	24.29	3.57
\$5,000-9,999	100.00	37.51	13.20
\$10,000-14,999	100.00	57.93	30.76
\$15,000-19,999	100.00	71.92	44.83
\$20,000-24,999	100.00	79.34	54.85
\$25,000-29,999	100.00	79.14	55.26
\$30,000-50,000	100.00	83.91	61.57
\$50,000 and over	100.00	84.90	68.50

	Percentage Distribution Across Income Groups		
	% Employ- ment	% of Coverage	% of Total Vesting
Total	100.00%	100.00%	100.00%
\$1-4,999	12.47	5.14	1.30
\$5,000-9,999	19.08	12.13	7.33
\$10,000-14,999	22.20	21.80	19.87
\$15,000-19,999	16.32	19.89	21.83
\$20,000-24,999	12.81	17.22	20.43
\$25,000-29,999	6.87	9.21	11.04
\$30,000-50,000	8.23	11.71	14.75
\$50,000 and over	2.01	2.89	4.01

*Excludes workers without reported earnings

SOURCE: Employee Benefit Research Institute tabulations of May 1983 EBRI/HHS CPS pension supplement.

Chart 8 Health Insurance by Earnings



Source: Employee Benefit Research Institute

Chart 9

Health Insurance by Earnings

Percent of All Workers with Coverage

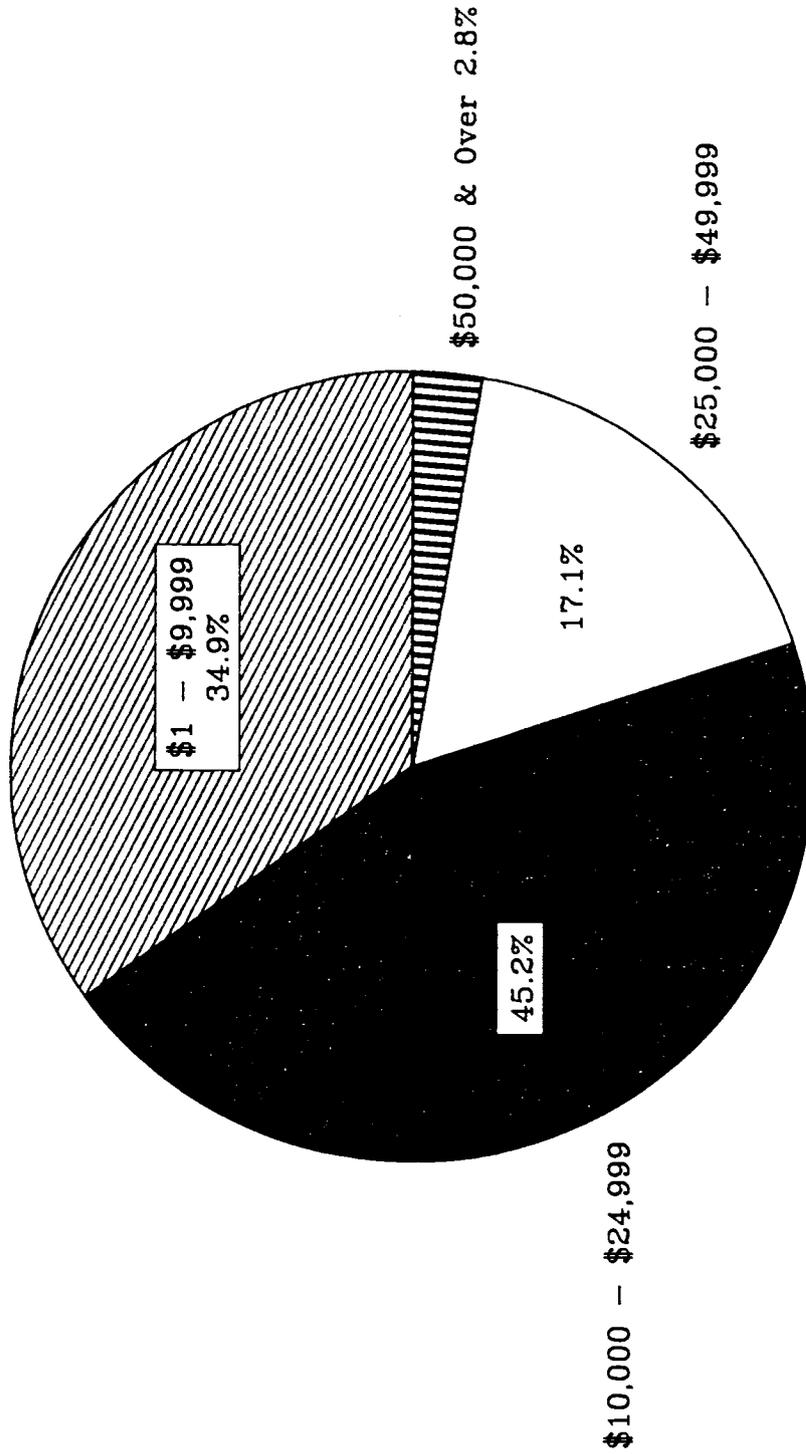


Table 6
 Distribution of Workers
 Covered by an Employer Group Health
 Insurance Plan by Personal Earnings, 1982 a/

Personal Earnings	Workers with Employer Coverage <u>b/</u> (in millions)	Percent of Workers within Earnings Group	Percent of All Workers with Employer Coverage
Loss	1.1	41.2	0.5
\$ 1-\$ 4,999	29.5	53.3	18.4
5,000- 7,499	10.8	64.6	8.1
7,500- 9,999	9.1	74.1	7.9
10,000- 14,999	19.0	84.7	18.8
15,000- 19,999	14.3	90.0	15.1
20,000- 24,999	10.5	92.5	11.3
25,000- 29,999	6.8	93.6	7.5
30,000- 34,999	4.2	93.0	4.6
35,000- 39,999	2.3	93.0	2.5
40,000- 49,999	2.3	90.8	2.5
50,000- 59,999	1.1	91.1	1.2
60,000- 74,999	0.7	88.3	0.7
75,000 or more	0.9	86.2	0.9
Total, All Workers <u>c/</u>	112.7	75.9	100.0
<u>Summary:</u>			
Loss-\$ 9,999	50.5	59.2	34.9
\$10,000- 24,999	43.8	88.3	45.2
25,000- 39,999	13.4	93.3	14.6
40,000 or more	5.1	89.7	5.3

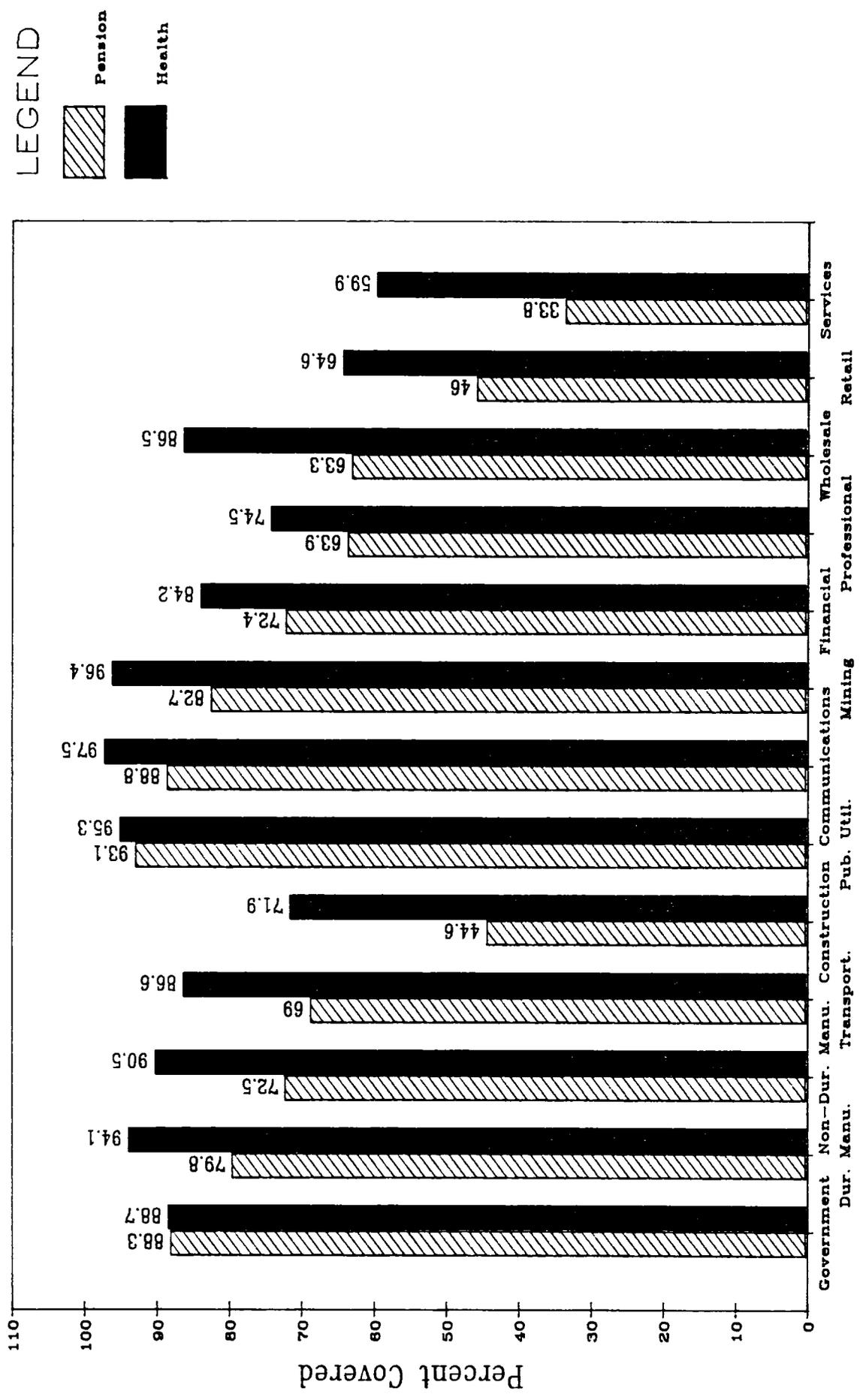
SOURCE: Employee Benefit Research Institute tabulations of the March 1983 Current Population Survey (U.S. Department of Commerce, Bureau of the Census).

a/ Includes all nonagricultural civilian workers who reported employer group health insurance coverage at any time during 1982, except workers in families in which the greatest earner is a member of the Armed Forces or an agricultural worker.

b/ Includes coverage from the worker's own employer group plan or from the plan of another worker.

c/ Items may not add to totals because of rounding.

Chart 10 Coverage by Industry



Source: Employee Benefit Research Institute

Table 7

Employment and Coverage in the
ERISA Work Force by Industry, May 1983

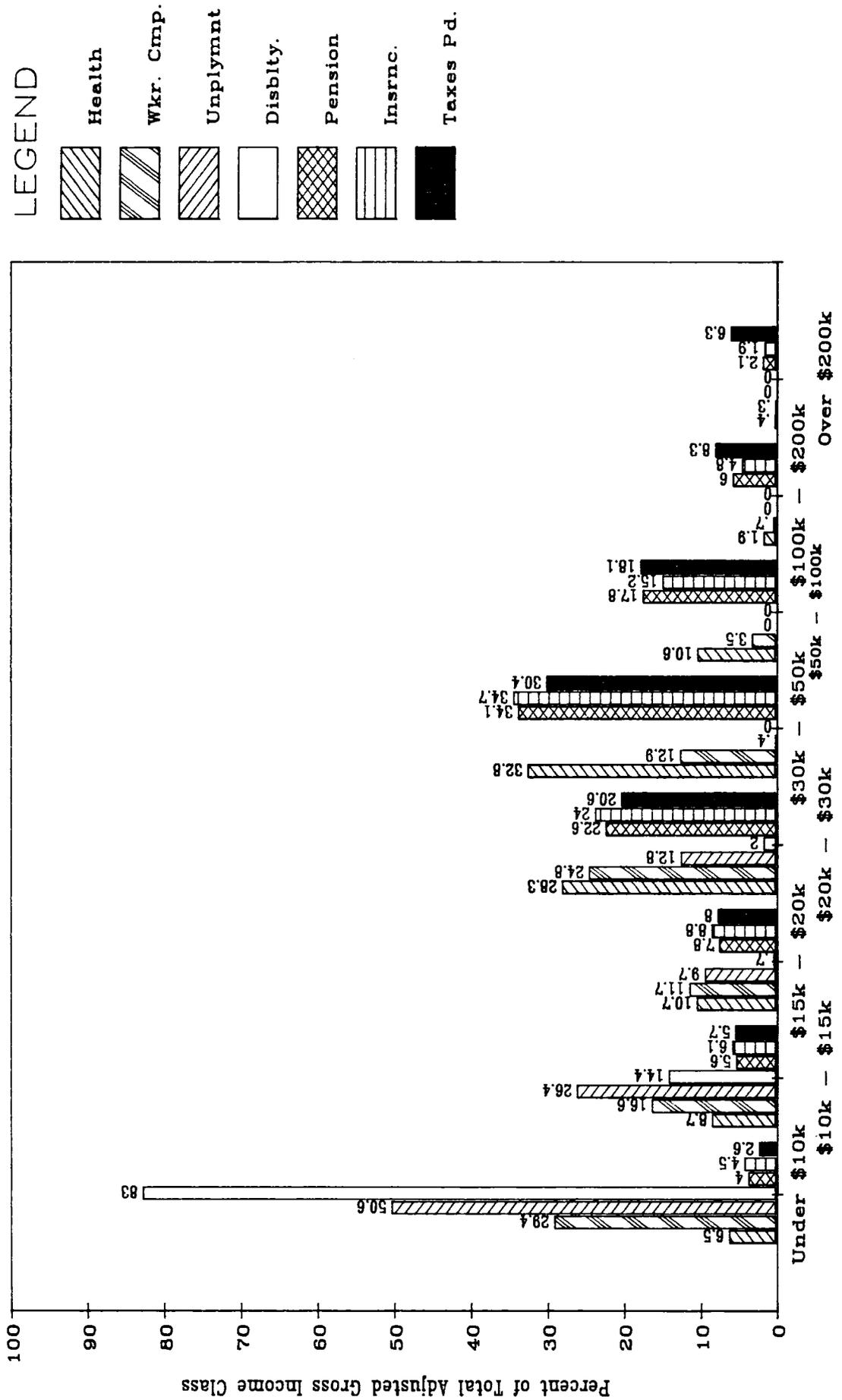
INDUSTRY	Employment (000's)	Percent Covered	
		Pension	Health
GOVERNMENT	11,905	88.26%	88.73%
DURABLE MANU.	8,492	79.84	94.17
Primary Metals	702	89.81	97.70
Automobiles	823	92.56	98.41
NONDURABLE MANU.	5,862	72.56	90.52
Apparel	697	45.82	75.55
Chemicals	970	91.89	97.38
TRANSPORTATION (ex-railroads)	1,454	68.98	86.56
CONSTRUCTION	2,130	44.56	71.93
PUBLIC UTILITIES	811	93.11	95.30
COMMUNICATIONS	1,200	88.75	97.46
MINING	660	82.72	96.43
FINANCE, INSURANCE & REAL ESTATE	3,444	72.42	84.20
PROFESSIONAL SERVICES	6,401	63.95	74.48
WHOLESALE TRADE	2,682	63.26	86.50
RETAIL TRADE	5,833	45.96	64.56
BUSINESS & PER- SONAL SERVICES	3,184	33.83	59.92

SOURCE: Preliminary Employee Benefit Research Institute tabulations of the May 1983 EBRI/HHS CPS pension supplement and May 1979 DOL/SSA CPS pension supplement.

^a Number of workers too small to be statistically significant.

Chart 11

Benefits Revenue Loss and Taxes Paid



Source: Employee Benefit Research Institute

Table 8

Revenue Loss for Major Benefits and Taxes Paid by Income Class as
Percent of Total Adjusted Gross Income Class, 1981^a

Adjusted Gross Income Class	Exclusion of Employer Con- tributions for Medical Insurance & Medical Care	Exclusion of Worker's Com- pensation Benefits	Exclusion of Untaxed Unem- ployment In- surance Benefits	Exclusion of Disability Pay	Not Exclusion of Pension Con- tributions & Earnings ^b	Exclusion of Insurance Premiums ^c	Percent of Total Taxes Paid
Less than \$10,000	6.5%	29.4%	50.6%	83.0%	4.0%	4.5%	2.6%
\$ 10,000 to \$ 15,000	8.7	16.6	26.4	14.4	5.6	6.1	5.7
\$ 15,000 to \$ 20,000	10.7	11.7	9.7	0.7	7.8	8.8	8.0
\$ 20,000 to \$ 30,000	28.3	24.8	12.8	2.0	22.6	24.0	20.6
\$ 30,000 to \$ 50,000	32.8	12.9	0.4	-	34.1	34.7	30.4
\$ 50,000 to \$100,000	10.6	3.5	-	-	17.8	15.2	18.1
\$100,000 to \$200,000	1.9	0.7	-	-	6.0	4.8	8.3
\$200,000 and over	0.4	0.3	-	-	2.1	1.9	6.3

SOURCE: EBRI calculations based on U.S. Congress, Congressional Budget Office, Revising the Individual Income Tax, July 1983 (Washington, D.C.: U.S. Government Printing Office, 1983), Table 9, pp. 62 and 63.

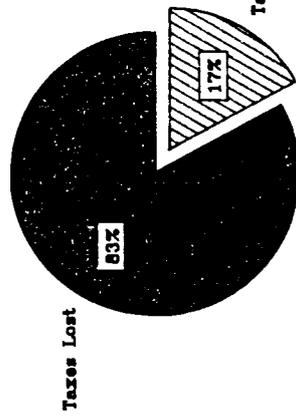
NOTE: Percents may not add to 100.0 percent due to rounding.

^a 1981 income levels and 1982 law.

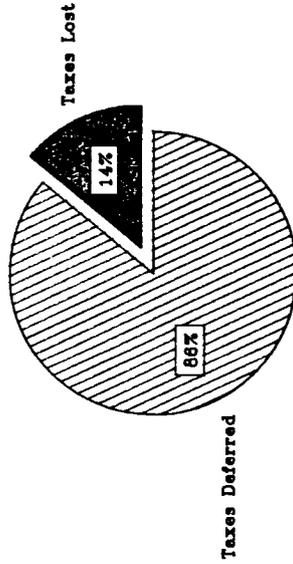
^b Includes the exclusion of contributions and earnings for employer plans and plans for the self employed and others.

^c Includes premiums for group-term life insurance and accident and disability insurance.

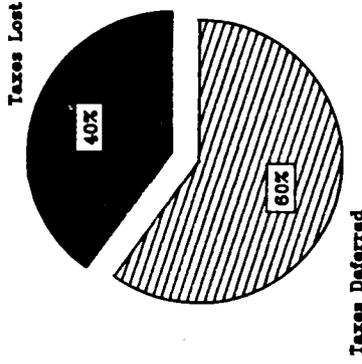
Chart 12 Pensions Revenue Lost Vs. Deferral



Treasury Cash Flow



Lifetime - Nominal



Lifetime - Real/Discounted

How Much of Pension-Related Tax Deferrals is Lost to the Treasury?

Method Used	Taxes Lost	Taxes Deferred
Treasury Method	83%	17%
<u>Lifetime Method:</u>		
Nominal dollars <u>a/</u>	14	86
Real dollars <u>b/</u>	28	72
Discounted for interest: <u>c/</u>		
at pension rate	40	60
at federal rate	36	64

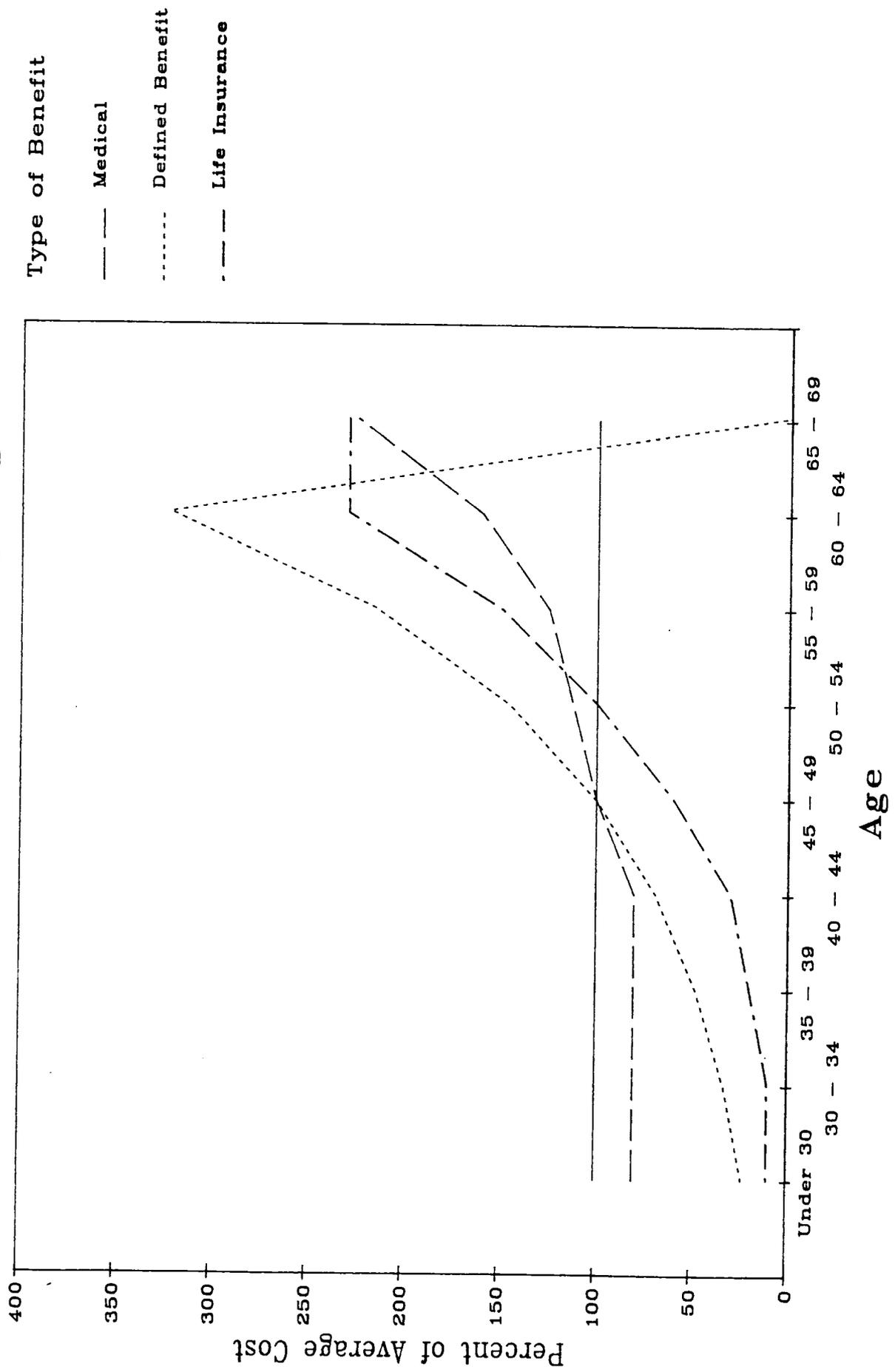
SOURCE: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984).

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.

Chart 13 Benefit Cost by Age



Source: Employee Benefit Research Institute

Table 10

Summary of Cost Factors by Age for Use in Costing Benefit Plans

<u>Age Group</u>	<u>Medical Cost Factor as % of Average Cost</u>	<u>Defined Benefit Cost Factor as % of Average Cost</u>	<u>Life Insurance Cost as % of Pay for One Times Pay</u>
Under 30	80.0%	23.0%	0.1%
30-34	80.0%	33.0%	0.1%
35-39	80.0%	48.0%	0.2%
40-44	80.0%	69.0%	0.3%
45-49	100.0%	100.0%	0.6%
50-54	112.5%	146.0%	1.0%
55-59	125.0%	216.0%	1.5%
60-64	160.0%	323.0%	2.3%
65-69	225.0%	*	2.3%

SOURCE: The Costs of Employing Older Workers (Washington, DC: U.S. Special Committee on Aging and the Employee Benefit Research Institute, forthcoming).

Note: Same life insurance cost is assumed for 65-69 as for 60-64 because it is assumed that the benefits will be reduced to equal cost; regulations allow a 30% reduction.

If benefits are not reduced, assume costs at 65-69 are about 30% higher.

Defined contribution costs are the same by age.

Endnotes: Should you wish to review the primary economic research on which this statement is based the following are suggested.

•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, DC: Employee Benefit Research Institute, 1982); EBRI Issue Brief, "Flexible Compensation and Public Policy," no. 24 (Washington, DC: Employee Benefit Research Institute, November 1983); and Chapter XXII, "Flexible Compensation Plans" in Fundamentals of Employee Benefit Programs (Washington, DC: Employee Benefit Research Institute, 1983).

•For further analysis of the tax treatment issues, see Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984). See also EBRI Issue Brief "Pension-Related Tax Benefits," no. 25 (Washington, DC: Employee Benefit Research Institute, December 1983); and EBRI Issue Brief "Employee Benefits and the 1985 Reagan Budget," no. 27 (Washington, DC: Employee Benefit Research Institute, February 1984).

•For discussion of the interrelationship of programs see Sylvester J. Schieber, Social Security: Perspectives on Preserving the System (Washington, DC: Employee Benefit Research Institute, 1982).

•Alternative 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 M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984) and EBRI Issue Brief, "Basic Tax Reform: Implications for Employee Benefits," no. 28 (Washington, DC: Employee Benefit Research Institute, March 1984). For a wide-ranging discussion of theoretical and practical issues in basic tax reform, see Dallas L. Salisbury, ed., Why Tax Employee Benefits? (Washington, DC: Employee Benefit Research Institute, 1984).

•In smaller plans, the cost of providing health insurance for the marginal employee is based on the average costs of insuring the insured population of that community. In larger plans, the cost of insuring the marginal employee is based on the average cost of insuring the population represented by that employer's work force. While these two methods would be likely to yield different insurance costs for any given employee, under either method the cost of insuring that employee does not represent the cost of that employee's expected claims.

•For a thorough discussion of health insurance see Deborah J. Chollet, Employer-Provided Health Benefits: Coverage, Provisions, and Policy Issues (Washington, DC: Employee Benefit Research Institute, 1984), p. 94. An EBRI simulation of private health insurance suggests that 56 to 87 percent of all covered workers with 1979 family income less than \$15,000 would not have purchased private health insurance if an employer had not offered and contributed to their health insurance plan.

Appendix I

What Are Employee Benefits?

Employee benefits represent virtually any form of compensation that is provided in a form other than direct wages, paid for in whole or in part by the employer, even if provided by a third party. Generally, media articles, cost surveys, and reports lump all benefits together. But different benefits serve different social and economic needs. For legislative policy assessment purposes, benefits can be classified into at least nine categories:

1. legally required benefits (including employer contributions to Social Security, Medicare, unemployment insurance, and workers' compensation insurance);
2. discretionary benefits that are fully taxable (primarily, payment for time not worked);
3. discretionary benefits that insure the employee against financial risks and are tax exempt (including employer contributions to health, life, and disability insurance plans);
4. discretionary benefits that help the employee meet special needs and are tax exempt (including employer contributions to child care and legal plans);
5. discretionary benefits that have traditionally been called fringes and are intended to meet employer needs and are tax exempt (including employer provision of purchase discounts, job site cafeterias, special bonuses and awards, van pools, clubs, and parking);
6. discretionary "reimbursement account" benefit programs that have been legally allowed since 1978 which allow employees to have reimbursement accounts--funded by the employer or through salary reduction--to pay expenses that fall into "statutory benefit" areas and are tax exempt (including health care reimbursement, child care reimbursement, etc.);
7. discretionary benefits that provide retirement income as a stream of payments and for which taxes are deferred until benefits are received (including employer contributions to defined benefit pension plans and to defined contribution plans which require payment in the form of an annuity);
8. discretionary benefits that provide for the deferral of salary until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, to money purchase plans and ESOPs); and

9. discretionary benefits that provide for the deferral of salary until special needs arise (loans and hardship), or until termination of employment, generally pay benefits as a lump sum, and for which taxes are deferred until benefits are received (including contributions to some profit sharing plans, thrift-savings plans, and salary reduction plans).

Appendix II

June 18, 1984

A Comment on the Controversy Over
Tax Expenditure Estimates for Pension Plans

Dallas L. Salisbury*

The United States Treasury makes annual estimates of tax expenditures in response to mandate of the Congressional Budget Act of 1974. These estimates are published each year in the President's Budget along with many cautionary notes on how they can legitimately be used.

A reading of academic, public, and other publications leads one to the irrefutable conclusion that these cautions are frequently unheeded. For example, some use them to indicate the revenue that would be gained by the government if the law were changed. The Budget points out that this is not a proper use of the numbers because, among other reasons, they are calculated as if no other tax provisions existed and as if human behavior would in no way be affected by eliminating the tax preference.

The Employee Benefit Research Institute (EBRI) is concerned with economic security and with doing what it can to assure that policy makers have appropriate information available to them as they assess policy choices. Early in 1983, EBRI received press inquiries regarding the tax expenditure numbers in the FY 84 Budget. As a result of those discussions, the then EBRI research director and economist Sylvester J. Schieber wrote and published EBRI Issue Brief Number 17 (April 1983) on the subject of "Retirement Program Tax Expenditures."

Alicia H. Munnell suggests in her note on this subject that the Issue Brief "initiated the debate over the accuracy of the

* President, Employee Benefit Research Institute. The views expressed herein are the authors and should not be attributed to EBRI.

estimates." The literature indicates that this debate has been ongoing, but I will agree that the Issue Brief was an addition to the debate. Munnell then mentioned that "a primary concern of EBRI was that the figures published by the Treasury jumped dramatically and apparently without explanation from year to year."

The Issue Brief raised other concerns as well:

- Budget deficits might cause pension policy to be made based upon considerations of perceived cost without sufficient consideration of benefits provided.
- Tax expenditure estimates could be used inappropriately as indicators of revenue that could be gained by changes in the tax treatment of pensions without reference to the limitations inherent in the numbers which are outlined in the budget.
- Dramatic increases in the numbers which were unexplained might inappropriately be attributed to a changed pension system rather than inclusion of public pensions for the first time.

The Issue Brief then explored the question of whether or not the figures, as presently published by the Treasury, accurately reflect the revenue loss associated with the favorable tax treatment of pensions. Munnell's note failed to deal with the most important factor in making this determination: the partial equilibrium nature of the Treasury calculations. Partial equilibrium means that real world behavior is assumed away. That is, if the law is changed, everyone is assumed to still behave in exactly the same way. If the IRA tax preference were removed, people would still put their money in IRA's. The budget goes to great lengths to warn against using the tax expenditure numbers to assess how much revenue could be gained if a particular tax incentive were removed. In other words, no partial equilibrium number is "accurate."

Munnell then says that "two arguments could be made that the calculated figures exaggerate the impact of employer-sponsored pension plans on tax revenues." She is correct that pension fund earnings may be overstated. She is also correct that contributions overstate the cost of current benefits. She ignores other reasons however. For example:

- Other tax code provisions such as the elderly double exemption bring marginal rates down. This reduces pension repayment and increases what is

called the pension tax expenditure. But this increase is due to the other provision.

- The cross section approach used in the budget offsets this year's contributions and earnings against benefits paid this year. These numbers relate to different groups of people and fail to account for the age of the pension system or the fact that this relationship will change in the future. This overstates the tax expenditure today and will understate it thirty years from now.
- The current method of calculation counts as pension tax expenditures amounts that would not be taxed in the absence of pensions due to other provisions of the code such as capital gains tax deferrals, municipal bonds, the elderly real estate gain exclusion, etc.

Munnell then quickly notes: "On the other hand, the revenue loss for public plans is almost certainly underestimated since these funds are not fully funded and hence contributions are less than accruing benefits." Whether under Social Security, civil service retirement, military retirement or private pensions, the concept that the tax expenditure should be calculated on the benefit accrual rather than contributions is revolutionary. Under such a new approach the Social Security and Medicare tax expenditures would dwarf those for pensions, and employees would be "charged with income" that they might never see due to the benefits being unfunded. Munnell's new approach cannot be justified. Yet, it is the only reason she provides for stating that the tax expenditures are understated.

Therefore, Munnell's conclusion that "In view of the offsetting errors, then, the Treasury's current estimates of the tax expenditure for pension plans probably provide a reasonable approximation of the revenue loss" cannot be supported. And Munnell certainly does not document it in her note.

Munnell then states: "Essentially, the calculation is designed to measure how much higher federal revenues would be in a given year if a particular subsidy had not been enacted." This statement directly contradicts the budget of the United States. The budget specifically warns against using the number for this purpose because of its partial equilibrium limitations. The number could only be used in this way if the preference being evaluated were the only tax preference item available.

Munnell then agrees with the Issue Brief in noting that a lifetime basis should be used to calculate the pension tax

expenditure. Munnell then undertakes a partial equilibrium present value exercise that approximates a lifetime estimate. She produces a high number and concludes: "Thus, the revenue loss associated with the favorable treatment of pension contributions and earnings is substantial regardless of how it is measured."

Again, Munnell cannot support her numbers or her conclusion. By using the current level of contributions, investment earnings and benefit payments, Munnell assumes that the system will never change. Demographic changes in the future will guarantee that this assumption is wrong. Further, Munnell's new calculation is still partial equilibrium and has all the weaknesses that the budget attributes to the Treasury numbers.

Munnell concludes her note with the comment that: "The debate over the precise magnitude of the tax expenditure is an unproductive digression that diverts attention from the important topic of whether the favorable tax treatment accorded contributions to private pension plans represents an efficient and equitable use of scarce federal resources."

The problem is that one can only assess whether benefits are sufficient to justify the cost, if one knows the cost. The tax favored pension plans will, according to government estimates, pay \$87.5 billion in benefits to retirees in 1985. What should this be measured against? \$28 billion; \$50 billion; \$62 billion? Do all these numbers indicate that at this point the government gets more than it gives?

Munnell never mentions anything but the tax expenditure. Her articles don't provide the information that would allow one to pursue the "important topic." Munnell is prepared to use the tax expenditure number in a way that the budget says it cannot be used; EBRI is not. EBRI attempts to provide information to allow persons to assess both the cost and the benefit issue; Munnell does not. Munnell advocates particular policy courses; EBRI does not.

EBRI subscribes to the American notion that there is a role to be played by the public sector, the private sector, and the individual in meeting economic security needs; Munnell's written work indicates that she believes it could best be done by Social Security. Munnell distributes critiques of the work of others without first discussing the work being critiqued with the author--as the Munnell note evidences; EBRI does not.

A debate over any established public policy is justified and further, should take place from time to time to assure that a national consensus still exists. Such debate, when it involves the pension benefits of over 16 million current retirees and

over 50 million current workers, must be based upon an accurate assessment of costs and benefits--as should all debates. No time spent attempting to get to accurate numbers can legitimately be labeled "an unproductive digression." Those who feel that a call for facts is "an unproductive digression" cannot be viewed as objective analysts. Thus, Munnell should be seen as an advocate for the policy positions she has articulated in her written work. Munnell has already reached her conclusions without aid of accurate estimates of the cost of the pension tax incentives and without the facts on the benefits the system provides. EBRI is doing over \$1 million in research each year to get the facts. Whatever they are, they are broadly distributed. They will, in time, provide the basis for informed decisions on whether tax incentives for pensions are efficient and effective. They have already provided a basis for more complete understanding than was possible when Munnell reached her conclusions in 1981.