



Statement On
Retirement Income Security In The United States
of

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Submitted to the Subcommittees on
Social Security and Oversight of the Committee on
Ways and Means
U.S. House of Representatives

*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.

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Contents

1a.	What is retirement?	4
1b.	What level of work activity separates the working from the retired?	4
1c.	What should the role of post-retirement earnings be in a retirement income security system?	4
1d.	Do demographic and economic changes expected over the next 30 years warrant a change in the definition of retirement itself?	5
2a.	What are the major sources of retirement income today?	5
2b.	To what extent do retirees now depend on pension plans, Social Security and savings for retirement income?	7
2c.	What is the desirable "mix" for the various sources?	8
3a.	How can we define "adequate" retirement income security?	8
3b.	What is a desirable level of post-retirement income in terms of replacement of earnings?	8
3c.	To what extent should our retirement system guarantee that level of income in retirement, and to what extent should individuals bear the responsibility and risk for providing for themselves?	10
3d.	How close to that level of adequate retirement security are we today?	11
4a.	What role does federal tax policy play in retirement income security?	11
4b.	What were the current income tax code provisions concerning qualified pension plans, cash and deferred arrangements, etc. designed to do?	12
4c.	Are they achieving those goals currently?	13
4d-i.	How efficient is the current structure in distributing tax benefits?	15
4d-ii.	How efficient is the current structure in assuring pension coverage across income levels?	24
4e.	Should these provisions be designed to encourage exclusively retirement income security, or are other goals equally important?	32
4f.	How does this system of tax incentives for qualified pension plans as well as for increased savings through cash or deferred compensation plans and individual retirement accounts fit in with current debate over basic tax reform?	34

Chairman Pickle and Chairman Jones, it is a pleasure to make a submission for the record of your hearing of July 18, 1985, on the subject of Retirement Income Security in the United States.

I would like to begin by commending you and the other members of this Committee for scheduling this hearing on a subject of special importance to today's workers and retirees.

I think it especially appropriate for the Employee Benefit Research Institute (EBRI) to be providing background information for this hearing. EBRI is a nonprofit, nonpartisan research organization based in Washington, DC. EBRI does not make recommendations for or against legislation the Congress may be considering, but we are pleased to make available to you and the Committee all the pertinent facts that may bear on your decisions.

In an April 1985 survey conducted by Hamilton and Staff, 58 percent of full-time workers rated the existence of a pension plan at work as being "very important." Only 15 percent of those polled felt that Social Security would be a major source of retirement income. Sixty-four percent believed they would have enough money in retirement, though most of these apparently believed that employer-sponsored pensions would enable them to achieve that goal. When asked if they would have enough to retire with a reduced pension, only 24 percent answered "yes." A full 82 percent of employees agreed with the statement that: "If employers did not provide benefits, the government would end up paying." The answers to these survey questions reflect the importance of employer-sponsored pensions to the American worker--and why this Committee is concerned about them.

The system of employer-sponsored pensions is becoming increasingly more important to the provision of retirement income nationwide.

The role of employers in providing pensions has increased dramatically, especially in the aftermath of World War II. Twenty-five thousand private

employer-sponsored retirement income and capital accumulation programs existed in 1950 with accumulated assets of \$12.7 billion. The participation rate for nonagricultural wage and salary workers was 25 percent.

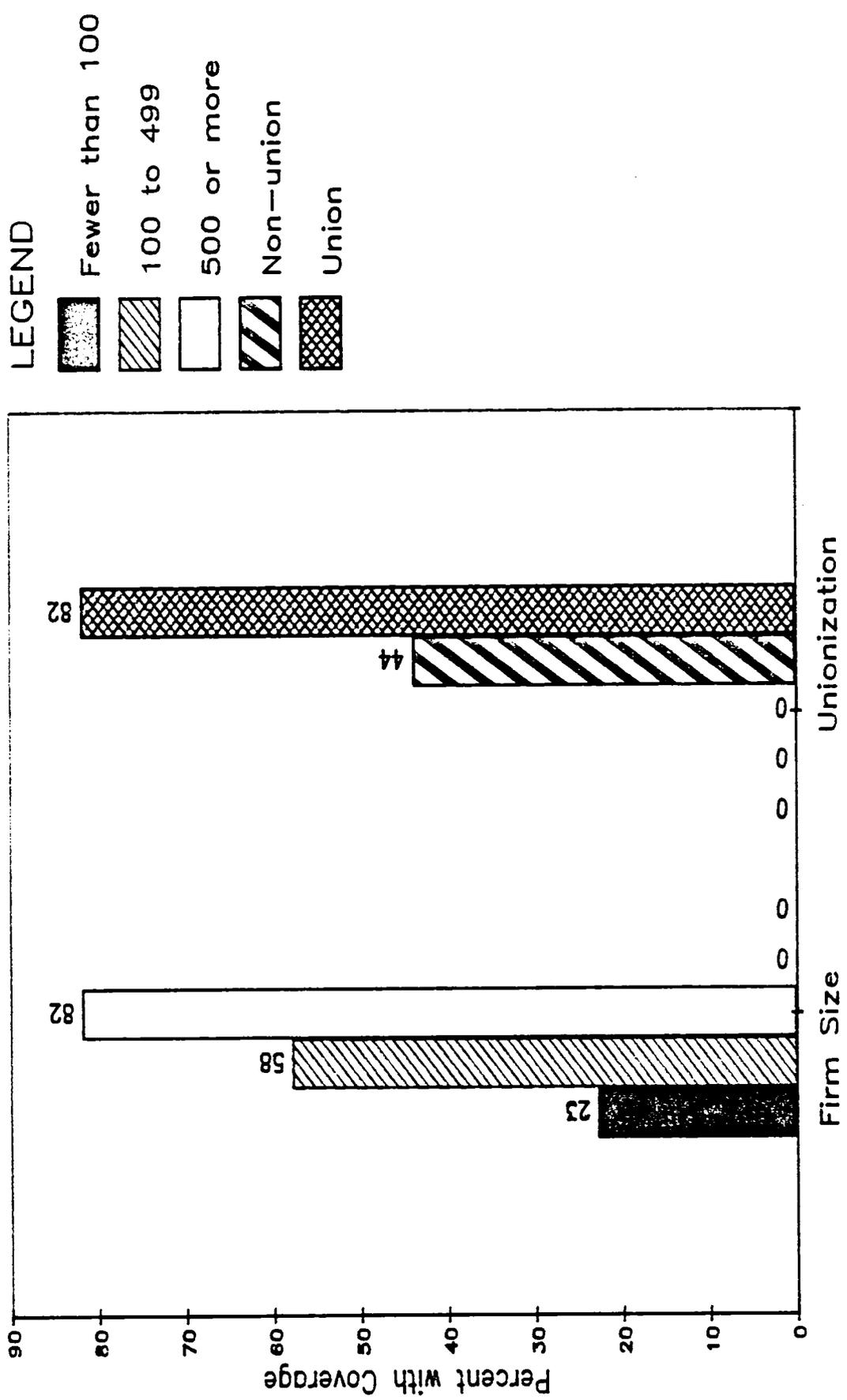
Over 800,000 private employer-sponsored retirement and capital accumulation plans exist today with accumulated assets exceeding \$925 billion. Were private pension plan assets to grow at the same rate as they have since 1968, which is highly questionable for a number of reasons, they would reach \$7.5 trillion by the year 2,000, according to some very rough estimates by EBRI. Today, there is an additional \$300 billion in assets in state and local plans, which could grow to \$2.7 trillion by the year 2,000, again according to our very rough estimates. The coverage rate for private nonagricultural wage and salary workers is more than 50 percent (see Chart 1) and over 80 percent for public-sector employees.

In 1950, the percentage of retirees receiving pension income was negligible. By 1962, 16 percent of retired married couples and 5 percent of unmarried retirees received pension income. By 1982, a Census Bureau survey found 33 percent of over-age 65 married couples and 15 percent of unmarried retirees had private pension income. The Social Security Administration recently found that among new beneficiaries substantial numbers of retirees had pension income from an employer-sponsored plan: 56 percent of married couples had pension income--38 percent with private pension, 21 percent with public pension; and 42 percent of unmarried beneficiaries had pension income--27 percent with private pension and 16 percent with public pension.

For the "newly retired" couple in 1981, in cases where only the husband receives a benefit, the average Social Security check was \$671 per month; those with pensions received an additional \$656. When both the husband and the wife received benefits, the monthly Social Security check rose to \$836

Chart 1

Percent of Non-Farm Private Employees with Pension Coverage,
by Firm Size and Unionization, May 1983



Source: Employee Benefit Research Institute

and the pension income rose to \$899. The pension income was greater than the asset income, which added \$539 per month.

As these statistics indicate, the retirement and capital accumulation plan system has grown significantly over the past 35 years in terms of participants, assets, benefit recipiency, and benefit amounts.

Now, I will turn to the specific questions you presented in the announcement of this hearing.

1a. What is retirement?

Retirement, according to the Random House dictionary, is to "withdraw from office, business, or active life." This can be a mandatory or voluntary event. Webster's is in general agreement: "to withdraw from one's position or occupation." The event of retirement is frequently identified with age, such as the "normal" retirement age under a pension program or the "mandatory" age of retirement.

Increasingly, retirement is marked as the point of eligibility for a pension from a particular job or from Social Security. For most, it represents the transition to a period during which earned income is no longer essential for the majority of one's income, even though it does not involve "withdrawal from active life" for most initial retirees today.

1b. What level of work activity separates the working from the retired?

An individual can be "retired" and still work a large number of hours per week. The truer measure is whether the individual economically needs to be working given the presence of pension income, and the type of work they are doing. The individual termed "fully retired" would not do compensated work.

1c. What should the role of post-retirement earnings be in a retirement income security system?

The nation should strive for a retirement income system that provides a reasonable enough level of income to retirees, at an age which is deemed reasonable for retirement, that they are not required to work. Why? Because the percentage who cannot work increases with each higher age group.

1d. Do demographic and economic changes expected over the next 30 years warrant a change in the definition of retirement itself?

The answer is not as simple as yes or no, since it is so dependent on health status and individual circumstances. Even though life expectancy is increasing (mortality experience), the jury is out on health status generally (morbidity). The nation will continue to be well served by a system that allows significant flexibility so that demographic and economic change can be accommodated, and, by a system that has a significant component that is "advance funded."

2a. What are the major sources of retirement income today?

The major sources of retirement income for elderly households are common among married and unmarried households, but the recipiency rates differ.

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Table 1

Income Sources for Elderly Households, 1982

	<u>Married %</u>	<u>Unmarried %</u>
Social Security	92	89
Employer Pensions	49	26
Property Income	77	61
Earnings	36	12
Other	13	18

Source: March 1983 Current Population Survey

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Table 2

Percent receiving retirement benefits other than social security: Retired-worker beneficiaries receiving first payable benefit in June 1980–May 1981, by PIA quartile, sex, and marital status

Sex and marital status	Total	PIA quartile			
		Low	Second	Third	High
Percent receiving—					
Own public or private pension or IRA or Keogh benefit					
Total	43	22	32	56	64
Men:					
Married	55	58	34	52	63
Unmarried	42	20	20	57	64
Women:					
Married	25	10	32	59	66
Unmarried	44	24	34	64	71
Own private pension					
Total	27	3	14	42	51
Men:					
Married	36	2	7	39	52
Unmarried	26	1	4	43	48
Women:					
Married	14	3	18	44	41
Unmarried	27	6	21	48	48
Own public pension					
Total	16	18	18	15	12
Men:					
Married	19	56	29	15	10
Unmarried	17	19	17	18	13
Women:					
Married	11	7	13	14	26
Unmarried	16	19	13	15	24
Own IRA or Keogh benefit					
Total	2	(1)	1	2	3
Men:					
Married	2	(1)	(1)	2	4
Unmarried	1	1	0	0	4
Women:					
Married	1	(1)	2	2	2
Unmarried	1	(1)	1	2	1

¹ Less than 0.5 percent.
Source: Appendix table A.

Source: U.S. Social Security Administration, *Social Security Bulletin*, Vol. 48, no. 5, Table 3 (Washington, DC: U.S. Government Printing Office, 1985), p. 10.

A recent report from the Social Security Administration indicates that new beneficiaries have more supplementation of Social Security at all income levels than the population of all retirees, and that supplementation frequency increases with income as the income replacement value of Social Security decreases ("Income of New Retired Workers by Social Security Benefit Level"). This data is presented in Table 2.

2b. To what extent do retirees now depend on pension plans, Social Security and savings for retirement income?

The tables cited above indicate the degree of receipt. The relative dollar value of alternative sources of retirement income is shown by data from the Survey of Income and Program Participation Current Population Reports (Household Economic Studies Series P-70, No. 4). Table 3 presents information for the second quarter of 1984 on the 84 million households surveyed on the relative value of alternative sources of income. Table 4 shows how earnings and benefit levels vary by income level and provides a view of the way in which alternative income sources fit together.

Table 3

Income Sources and Levels, 1984 Second Quarter

<u>Source</u>	<u>Number (millions)</u>	<u>Mean Monthly Income</u>	<u>Mean Amt. of Source</u>	<u>% of Tot. Income</u>
Social Security	23.5	\$1,590	\$562	35.3
Private Pension	7.2	\$1,902	\$394	20.7
Fed Pension	1.7	\$2,643	\$944	35.7
Mil Pension	1.3	\$3,555	\$1,014	28.5
St/L Pension	2.5	\$2,211	\$573	25.9

Source: Survey of Income and Program Participation

2c. What is the desirable "mix" for the various sources?

Social Security provides a floor of income protection for retirees. At the lowest income levels, for full career workers this can mean near total income replacement. For the highest earning quartile it might mean less than 25 percent of final pay. Employer-sponsored pensions in both the public and private sectors now provide additional income for a growing number of retirees. The President's Commission on Pension Policy (1980) recommended a set of target replacement rates for full career workers. On an after tax basis these ranged from 86 percent for the married couple earning \$6,500 in the year before retirement to 55 percent for the married couple earning \$50,000. Employer plans are frequently designed with a 60 percent target in mind (a common formula is 2 percent per year assuming 30 years of service).

Table 4 shows that the mean Social Security benefit paid to the lowest income retiree couples is equal to the mean earnings amount, while for the highest earners the Social Security benefit may represent only 10 percent of final earnings.

3a. How can we define "adequate" retirement income security?

Ideally individuals should be able to maintain a relatively constant life style after they retire, as compared to pre-retirement. The replacement rates noted above were designed to do this at alternative income levels after adjusting for reduced expenses and taxes. This could be termed "adequate." Further, "minimum" adequacy might be guided for the lowest income individuals and households as the benefit levels under Supplemental Security Income, unemployment compensation, or worker's compensation.

3b. What is a desirable level of post-retirement income in terms of replacement of earnings?

Table 4

**Households, by Income Level, Receipt of Earnings, and Income From
Selected Nongovernment Sources: Monthly Average, Second
Quarter 1984**

Source of income	Total	Monthly income						
		Under \$600	\$600 to \$1,199	\$1,200 to \$1,999	\$2,000 to \$2,999	\$3,000 to \$3,999	\$4,000 to \$4,999	\$5,000 and over
All households.....	84,002	12,375	15,466	18,936	17,461	9,569	4,718	5,478
Earnings:								
Number with.....	61,505	2,564	8,705	15,314	16,070	9,114	4,541	5,197
Mean amount.....	\$2,394	\$343	\$773	\$1,377	\$2,198	\$3,133	\$3,996	\$7,025
Property income:								
Number with.....	57,722	4,438	8,750	12,990	13,725	8,322	4,343	5,156
Mean amount.....	\$255	\$36	\$109	\$135	\$161	\$219	\$304	\$1,263
Company or union pensions:								
Number with.....	7,238	520	2,176	2,296	1,264	477	233	273
Mean amount.....	\$394	\$119	\$219	\$375	\$452	\$561	\$674	\$1,670
Social Security or railroad retirement:								
Number with.....	23,508	5,299	6,929	5,491	3,132	1,391	577	690
Mean amount.....	\$562	\$351	\$554	\$664	\$666	\$640	\$676	\$720

B Base less than 200,000.

Source: U.S. Bureau of the Census, Current Population Reports, Series P-70, No. 4, Economic Characteristics of Households in the United States: Second Quarter 1984, Table E (Washington, DC: U.S. Government Printing Office, 1985), p. 5.

The 60 percent replacement target noted above is generally viewed as reasonable, as long as there is a minimum payment program such as Supplemental Security Income available to take care of those who have not worked enough to earn work-related benefits.

3c. To what extent should our retirement system guarantee that level of income in retirement, and to what extent should individuals bear the responsibility and risk for providing for themselves?

Government policy should provide a floor of income on a mandatory basis. This is accomplished in this country through Social Security and other social programs. Social Security provides an "adequate" benefit for low-income, full-career workers by using a weighted and redistributive formula. This same formula means that higher income individuals receive a much lower benefit relative to income. A pay-as-you-go program should not be used to fill the "gap" for these persons. The government should provide incentives to encourage persons to save to supplement Social Security, even those at low income levels, due to high retiree medical and long term care expenses.

These incentives can be most effective when tied to employment. The federal government has recognized this by establishing military and civil service retirement systems. State and local government and private employers have done the same. These programs represent forced savings for retirement. Most state, local and private programs are advance funded so that present taxpayers, workers and stockholders pay for their own benefits. Above some retirement income level the government should require effort at the individual level without further incentive. (The law now specifies a limit on what employers can offer under Internal Revenue Code section 415. Individuals have to provide for themselves beyond this limit.)

3d. How close to that level of adequate retirement security are we today?

We are at that level (in terms of the targets set by the President's Commission) for full-career low-income workers, near that level for average income workers with a full-career attachment to the work force, and at a level of sufficiency for most higher income workers who have retired in recent years. Recent government reports indicate that the overall elderly poverty rate (14.1 percent) is lower than that for children (22 percent).

For those who have had limited attachment to the work force we still have a great distance to go -- almost one-half of all widows who are black and older than 65 were considered poor in 1983. This, however, is a test of our social commitment to those who have not worked, not a test of our employment-based programs.

4a. What role does federal tax policy play in retirement income security?

Tax policy plays a central role in retirement income security. Employees, whether they be federal, state and local government, or private sector, have a preference for forced savings, particularly forced savings on which taxes are deferred until benefits are received. Employers have provided these programs for decades as a means of allowing work-force adjustments while maintaining individual dignity. They have been encouraged to do so by the current tax treatment of contributions up to a certain level as deductible expenses.

Tax policy has also helped to assure that most workers at all earnings levels would have the opportunity to participate in programs so that Social Security benefits would be supplemented if they, alone, did not provide adequate benefits. Nondiscrimination standards in the law and restrictions on "integration" have resulted in broad-based participation and benefit receipt.

4b. What were the current income tax code provisions concerning qualified pension plans, cash and deferred arrangements, etc., designed to do?

These provisions of the law were designed to increase capital formation and to encourage workers to increase their level of saving; to provide a means for workers to have assets to allow lifestyle transitions upon termination of employment; to allow employers to restructure work forces while allowing workers to maintain a standard of living and their dignity; to supplement Social Security and in the process to keep additional demands from building on that program; and to provide an advance-funded component of the retirement income system.

These varied objectives were to be fulfilled by different types of plans: The first category of plans were strictly called pensions prior to 1974. These plans were specifically designed to provide retirement income as a stream of payments. Private employers generally pay all contributions in these plans. These plans include defined-benefit pension plans and defined-contribution plans which require payment of benefits in the form of an annuity.

The second category of plans are identified in ERISA as those which provide for capital accumulation until termination of employment. These plans were specifically designed to provide savings for use on a discretionary basis upon retirement or upon other separation from a job. These plans include defined-benefit and defined-contribution plans which pay out as a lump-sum distribution.

4c. Are they achieving those goals currently?

A number of different types of plans have developed since 1921 to fulfill these two sets of goals: retirement saving and capital accumulation.

Defined-benefit plans are plans which promise a certain final benefit. Private sector employers make all contributions and in the event of investment shortfalls the employer makes up the difference to assure the payment of promised benefits. 94 percent of these plans always pay benefits as a stream of payments; 6 percent allow lump-sum distributions in certain circumstances. As of the end of 1984 there were approximately 250,000 of these plans with 40 million participants.

Money purchase plans are plans which promise a certain contribution by the employer. The worker absorbs investment gains and losses. These plans generally encourage workers to select an annuity rather than a lump-sum distribution. The TIAA-CREF teachers retirement system is the equivalent of a money purchase plan which only pays benefits in annuity form. As of the end of 1984 there were approximately 180,000 of these plans in operation in the private sector.

Profit sharing plans are plans which usually "promise" a given percent of pay contribution to an individual employee account, with the dollar amount varying with corporate profitability. The worker absorbs investment gains and losses. Some of these plans allow the worker to chose to take a portion of the contribution

allocation as current salary rather than leaving it in the plan. Profit sharing plans generally pay benefits as a lump sum. Profit sharing plans are designed to increase worker productivity and worker interest in efficiency and profitability as well as to produce capital accumulation.

Thrift-savings plans represent an employee and employer partnership towards the goal of capital accumulation. Employees make contributions with after-tax dollars and employers generally provide a matching contribution into an allocated account for each worker. The employer contribution is not taxed as income to the employee until received. These plans meet an objective of individual savings, with funds generally paid out as lump-sum distributions.

Cash or deferred arrangements are increasingly referred to as salary reduction plans or by their code section, 401(k). The plans also represent an employee and employer partnership toward the goal of capital accumulation. Employees make contributions with pre-tax dollars and many employers provide a matching contribution into an allocated account for each worker. The employer contribution is not taxed as income to the employee until received. These plans meet an objective of individual savings, with funds generally paid out as lump-sum distributions.

Individual retirement accounts have been available to all workers since 1982. These accounts allow workers to contribute up to

\$2,000 (plus \$250 for a nonearning spouse) on a pre tax basis, with investment earnings receiving tax deferred treatment. During each year of general availability approximately 13 million tax returns have included contributions to IRAs.

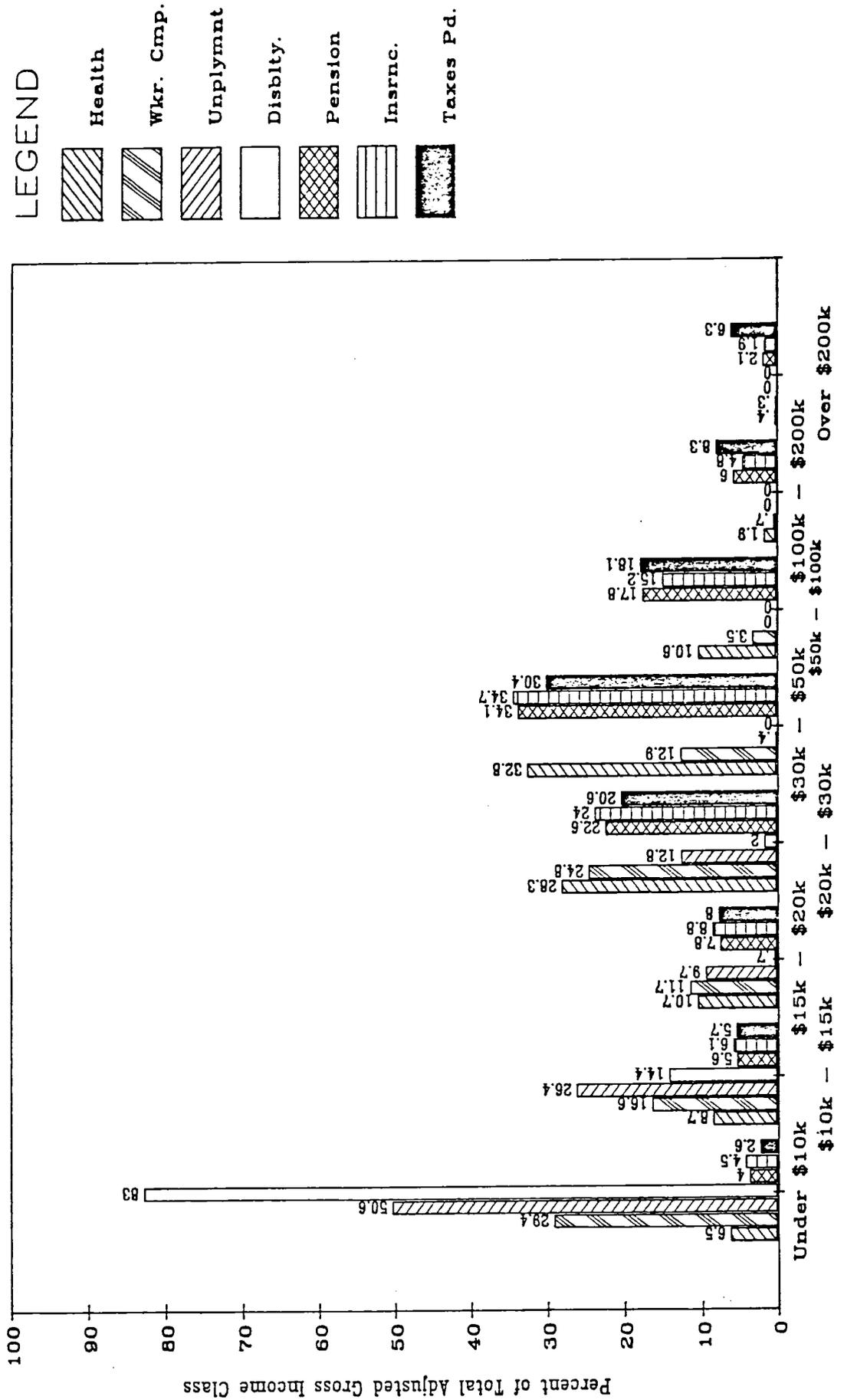
Each of these plans is responding to the goals set out for it in the tax law, as the tax law is currently written. If other goals are desired, then current tax policy has to be modified.

4d-i. How efficient is the current structure in distributing tax benefits?

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 (Chart 2). Chart 2 and Table 5 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 Congressional Budget Office (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. A major new study by Dr. Korczyk, Retirement Security and Tax Policy, 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

Chart 2 Benefits Revenue Loss and Taxes Paid



Source: Employee Benefit Research Institute

Table 5

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 Unemployment In- surance Benefits	Exclusion of Disability Pay	Net 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.

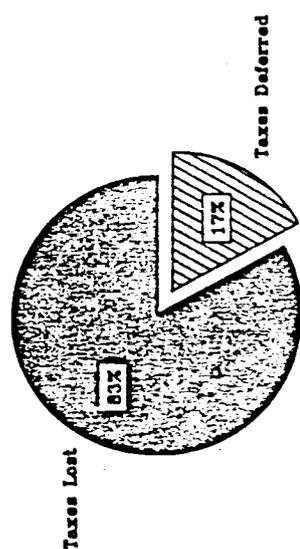
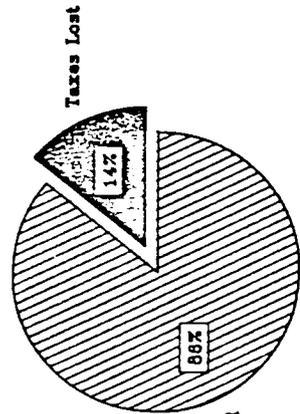
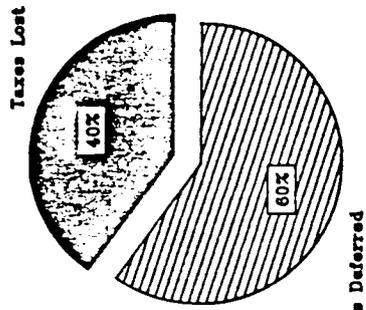
real (i.e., inflation-adjusted) value of taxes deferred during the pension participants' working career is ultimately repaid as income tax during retirement.

Chart 3 and Table 6 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 on 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 4 and Table 7).

Chart 3 Pensions Revenue Lost Vs. Deferral



Treasury Cash Flow

Lifetime - Nominal

Lifetime - Real/Discounted

Table 6

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

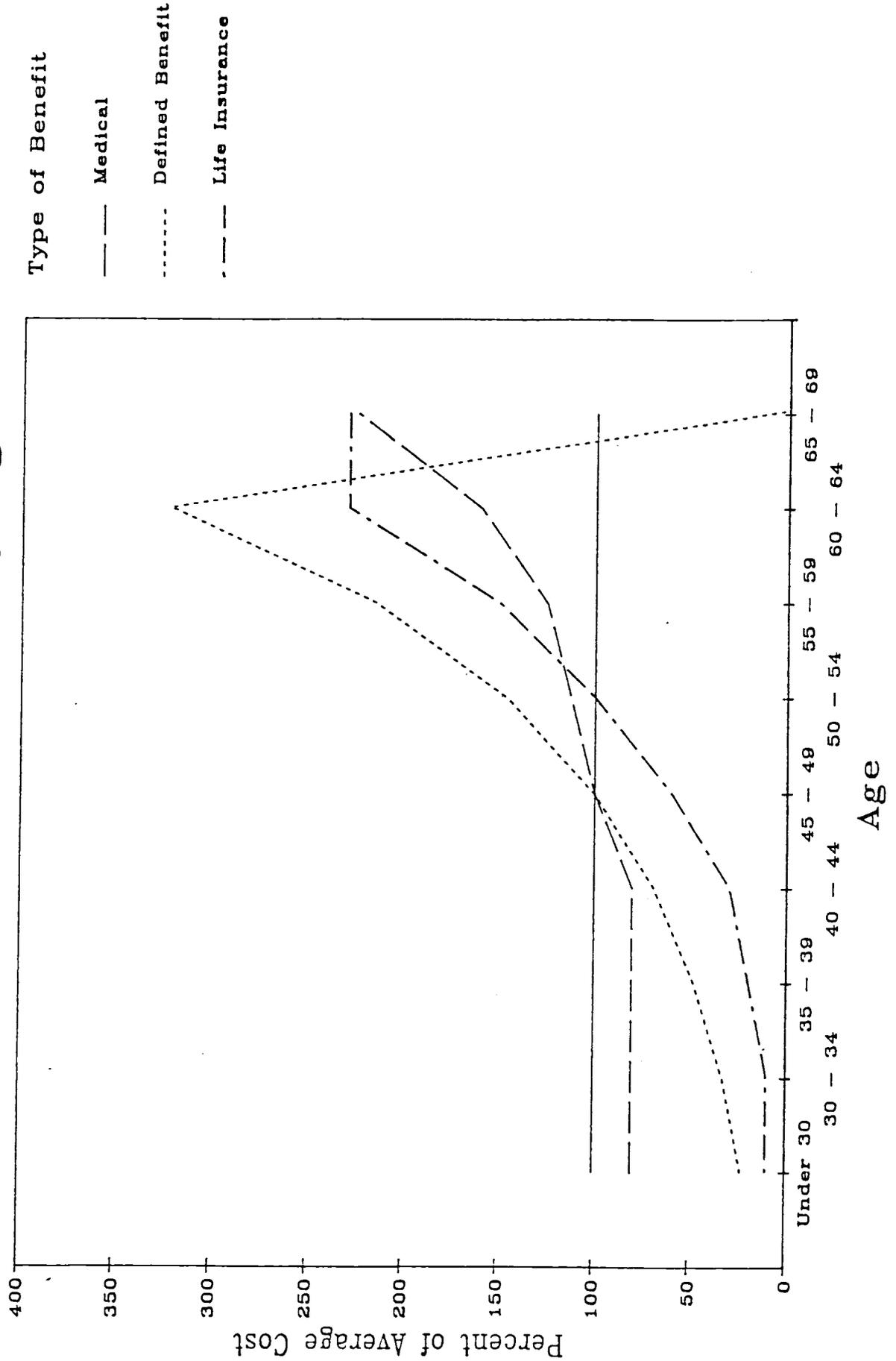
SOURCE: Sophie M. Korczyk, Retirement Security and Tax Policy (Washington, DC: Employee Benefit Research Institute, 1984).

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 4 Benefit Cost by Age



Source: Employee Benefit Research Institute

Table 7

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.

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 a system of 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 effect 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 were not available from an employer and largely paid for by the employer.

The previously referenced analysis by the Treasury Department shows that for employer-sponsored plans the tax benefits are distributed across the income spectrum in close relationship to income. The lowest income groups receive more of the tax benefit than the proportion of taxes they pay, while higher income workers receive less of the tax benefit than their share of tax payments. According to analysis by the Treasury Department the "tax subsidy" is distributed evenly across the income spectrum, with 76 percent of the value going to those earning less than \$50,000, as compared to 6 percent in the case of tax exempt municipal bonds and approximately half for

capital gains. In other words, the system is efficient given our progressive tax structure.

4d-ii. How efficient is the current structure in assuring pension coverage across income levels?

Coverage is efficiently spread across income levels. Among full-time employees over the age of 25, 70 percent are covered by a pension and 37 percent currently are entitled to a vested benefit. Of all civilian workers age 14 to 64, 52 percent are covered and 24 percent are entitled to a vested benefit. 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 and 70 percent of those vested earning less than \$25,000. 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.

There are still many workers not covered by a pension plan, but they are almost entirely accounted for by the reluctance of small employers to offer pension plans. Among medium and large employers, nearly all full-time workers are covered by a plan.

Individual retirement accounts are most frequently opened by individuals who have an employer-sponsored pension, as well, and the distribution is much more weighted toward high income individuals than coverage or vesting in employer-sponsored plans.

The absolute number of workers covered by pension and capital accumulation plans has continued to grow, but due to the large number of new jobs being created by small businesses, the percentage of the total work force covered by plans has declined. The primary reason: small business does not provide pension coverage at the high rate found in large businesses

(see Chart 1). If this does not change, then pension coverage is nearly as high as it can ever be expected to climb. The United Kingdom, for example, has had 50 percent of the work force covered by employer pension plans for twenty years.

It is difficult to increase coverage and participation. Last year, for example, Congress enacted the Retirement Equity Act (REA), which reduced the age for participation from 25 to 21, and the age for counting service for vesting from 22 to 18. EBRI estimates that these changes increased participation by 530,000 workers--or about 1 percent--and increased vesting by 300,000--or about 1 percent. In short, only 5.6 percent of the 9.5 million workers between the ages of 21 and 25 worked for employers with plans and worked at least 1,000 hours per year and had been on the job for one year. The improvements from REA are real, but such minimum standard changes are no replacement for increases in coverage through new plan creation among small businesses.

Forty-nine million of 88 million nonagricultural wage and salary workers were covered by employer-sponsored programs in May of 1983 (56 percent). Most covered workers earn relatively modest salaries. Over 76 percent of all covered employees and 70 percent of all vested employees earned less than \$25,000 a year in 1983 (see Table 8).

When one considers those that ERISA required to be included in employer plans--i.e., those between the ages of 25 and 64 working 1,000 hours per year and on the job at least one year--the base drops to 54 million workers, of which 38 million (70 percent) are covered by a private or public employer-sponsored plan (see Table 9).

Who is covered by an employer-sponsored plan is not a gamble. Coverage is a function of very predictable factors: in larger firms of more than 500

TABLE 8: 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	88,214	49,530	28,708
\$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	4,071
\$50,000 and over	1,615	1,371	1,106
Not reported	7,924	2,158	1,105
<hr/>			
	Percentage Distribution Within Earnings Group		
	Employment	% Covered to Employed	% Vested to Employed
Total	100.00%	56.15%	32.52%
\$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
Not reported	100.00	27.23	13.94
<hr/>			
	Percentage Distribution Across Earnings Groups ^a		
	% 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	21.28
\$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

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

^a Percentages exclude 9.0% of employees whose earnings are not reported.

TABLE 9: EMPLOYMENT, COVERAGE AND FUTURE BENEFIT ENTITLEMENT
BEFORE AND AFTER THE RECESSION, MAY 1983 AND MAY 1979

	Employment (000's and % of Employed)	Coverage (000's and % of Employed)	Future Benefit Entitlement (000's and % of Employed)
<u>1983</u>			
Civilian Employment (All employees & self- employed)	98,964 100.00%	51,530 52.07%	24,095 24.35%
Nonagricultural Wage and Salary Workers	88,214 100.00%	49,530 56.15%	22,217 25.19%
Nonagricultural Wage and Salary Workers age 25 to 64 only	68,252 100.00%	42,463 62.21%	20,934 30.67%
Nonagricultural Wage and Salary Workers age 25 to 64, working 1000 hours or more	61,586 100.00%	40,702 66.09%	20,476 33.25%
ERISA Work Force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	54,363 100.00%	38,057 70.01%	20,027 36.84%
<u>1979</u>			
Civilian Employment (All employees & self- employed)	95,372 100.00%	53,445 56.04%	22,633 23.73%
Nonagricultural Wage and Salary Workers	85,181 100.00%	52,019 61.07%	21,399 25.12%
Nonagricultural Wage and Salary Workers age 25 to 64 only	63,201 100.00%	42,576 67.37%	19,836 31.39%
Nonagricultural Wage and Salary Workers age 25 to 64, working 1000 hours or more	58,009 100.00%	40,830 70.39%	19,522 33.65%
ERISA Work Force (age 25 to 64, working 1000 hours or more, one year of tenure or more)	49,736 100.00%	36,890 74.17%	18,941 38.08%

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

employees--82 percent of nonfarm private employees are covered; in unionized firms--82 percent of workers are covered; among those 45-64 years of age--65 percent are covered; and of workers in durable goods manufacturing, nearly 80 percent of the ERISA work force is covered, versus an unusually low 34 percent coverage of the ERISA work force in the business service sector.

Firm size and union status are clear predictors of whether an employer-sponsored pension plan will be available.

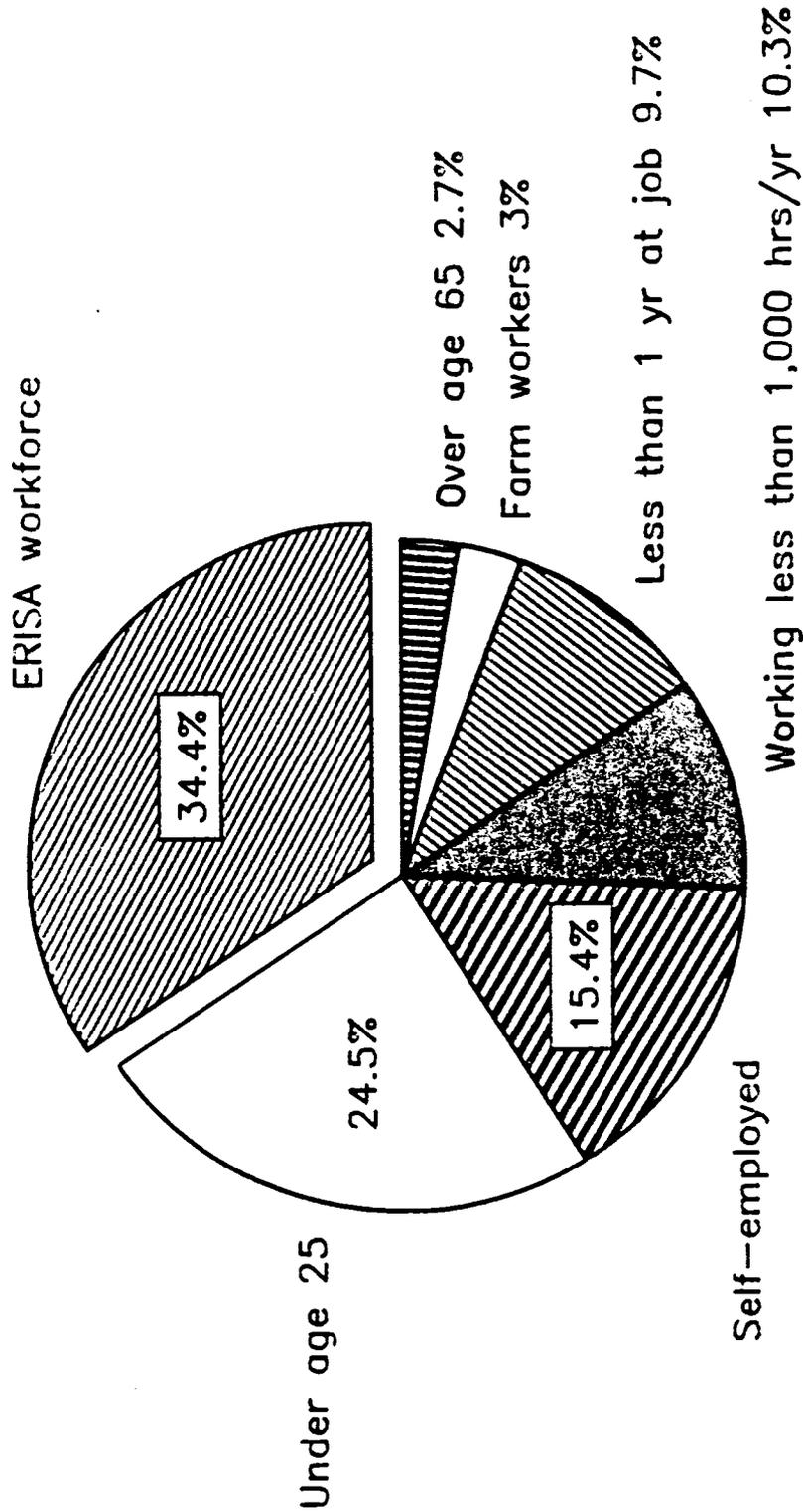
The statistics allow noncovered workers to be sorted into seven categories (see Chart 5). About 15.4 percent of noncovered workers own their own businesses. These self-employed workers appear to provide retirement protection for themselves through their investment in their business.

Three percent of noncovered workers are in agriculture. Their coverage rate is the lowest of all noncovered groups at just over 10 percent. Many agricultural employees are low-wage seasonal workers, employed on more than one farm. They frequently face a complex set of other labor market problems.

Nearly 25 percent of all noncovered workers in 1983 were under 25 years of age. This age group was not subject to ERISA participation standards according to the 1974 law. Young workers are more likely to have short years of service and to work part-time schedules.

Workers 65 years of age and older are also a special case; 2.7 percent of all noncovered workers fall into this group. ERISA states that defined-benefit plans may exclude all new employees within five years of normal retirement age. Furthermore, benefit accruals have not been required beyond the normal retirement age (usually age 65), although many employers do provide post-65 pension accruals.

Chart 5
Percent Distribution of Employees Lacking Pension Coverage
Across Employment Categories, May 1983



Source: Employee Benefit Research Institute

Note: "ERISA workforce" consists of all employees not included in other categories (employees meeting ERISA participation standards).

Workers without coverage who were on the job less than a year account for 9.7 percent of the noncovered, and those who usually worked less than 1,000 hours a year accounted for another 10.3 percent of all noncovered workers. ERISA standards state that pension plans only need credit a year of service to employees who work 1,000 hours or more under the plan.

Those workers meeting all 1983 participation standards, except that their employers did not sponsor a plan, made up the remaining 34.4 percent of all noncovered workers. This last group represents 16 percent of total employment.

Nearly 82 percent of all noncovered employees work for employers with less than 500 employees; 68 percent work for firms with less than 100 employees. Eighty-nine percent are in nonunionized jobs; 44 percent are under 35; 51 percent have been on their current job less than five years (see Table 10).

Vesting represents having a nonforfeitable right to a payment from the retirement or capital accumulation plan. This payment may be in the form of an annuity or lump-sum payment. If the accrued value is less than \$3,500 upon separation from service, the worker can be required to take the lump sum.

Nearly 58 percent of all those covered by an employer-sponsored plan today have a vested benefit in the plan at their current employment. Reduction to a five-year vesting standard, EBRI estimates, would vest approximately 1.9 million additional workers, increasing the percentage of covered workers with vested benefits to 62 percent. Defined-benefit plans, which currently have more than 40 million participants, now commonly use the ten-year "cliff" vesting standard allowed in ERISA. Defined-contribution plans, with approximately 28 million participants, use many different

TABLE 10

THE DISTRIBUTION OF COVERED AND NONCOVERED WORKERS
 IN THE "NEAR-ERISA" WORKFORCE
 AGES 25 THROUGH 64 WORKING 1000 HOURS OR MORE
 BY SELECTED CHARACTERISTICS, MAY 1983

	Covered Workers (000's)	Distri- bution Across Groups	Workers Not Covered ^a (000's)	Distri- bution Across Groups
=====				
FIRM SIZE ^b				
Less than 100 employees	6,215	17.4%	12,352	68.1%
100 to 499 employees	5,545	15.6	2,465	13.6
500 or more employees	23,869	67.0	3,314	18.3
Total	40,702	100.0	20,894	100.0
UNION STATUS				
Union	15,223	38.2	2,163	10.6
Nonunion	24,627	61.8	18,155	89.4
Total	40,702	100.0	20,894	100.0
EARNINGS ^d				
Less than \$10,000	4,107	10.4	6,711	34.6
\$10,000 to \$24,999	24,545	62.1	10,374	53.5
\$25,000 or more	10,866	27.5	2,309	11.9
Total	40,702	100.0	20,894	100.0
AGE				
Less than 35	14,588	35.8	9,095	43.5
35 and over	26,133	64.2	11,800	56.5
Total	40,702	100.0	20,894	100.0
HOURS				
Less than 2000	7,525	18.5	5,481	26.2
2000 and over	33,176	81.5	15,413	73.8
Total	40,702	100.0	20,894	100.0
SEX				
Women	16,335	40.1	9,932	47.5
Men	24,367	59.9	10,963	52.5
Total	40,702	100.0	20,894	100.0
TENURE ^e				
Less than 5 years	10,613	28.0	8,328	51.3
5 to 9 years	9,734	25.7	3,958	24.4
Ten years and over	17,518	46.3	3,830	23.6
Total	38,017	100.0	16,116	100.0

^aIncludes workers with no coverage, workers who do not know whether they have coverage and workers with no coverage information reported.

^bPercentages exclude 12.7 percent of employees for whom firm size is not known.

^cIncludes workers who are not covered by a union contract, workers who do not know whether they are covered under a union contract, and workers with no reported information on unionization.

^dPercentages exclude 4.4 percent of employees whose earnings are not reported.

^eTotal excludes 11.2 percent of employees who have worked at their current job for less than one year, doesn't include d/r.

SOURCE: Preliminary tabulations of EBRI/HHS May 1983 CPS pension supplement.

schedules, with the average vesting period being six years. Most public employer pension plans use five-year vesting.

This vesting level in current employment plans is complemented by benefit entitlement--vested status--earned under plans from previous employment. About 6.6 million workers reported entitlement to a pension benefit from a previous employer's plan in May 1983.

The number of individuals with vested benefits from current and former employment will continue to grow as the system matures and the work force continues to age. As an increasing number of employers adopt supplemental defined-contribution plans with shorter vesting schedules than the ERISA ten-year standard, an increasing number of workers will achieve vested status.

A reduction in the vesting minimum standard from ten years to five years would increase defined-benefit plan costs by between 2 and 7 percent of payroll, were the employer to maintain the same benefit formula. EBRI estimates indicate that the result could be many more workers being eligible for small benefit amounts. Under current law, the workers could be required to accept these small benefit amounts as immediate lump-sum distributions upon separation from employment. Under these current rules, data indicate that these amounts are generally consumed, rather than used to increase retirement income (see Table 11). In other words, faster vesting will only increase retirement income if workers are required to roll over distributions into another retirement plan.

4e. Should these provisions be designed to encourage exclusively retirement income security, or are other goals equally important?

Capital formation and savings are important to the nation. While studies indicate that IRAs are not yet adding to savings, employer-sponsored

TABLE 11

The Use of Preretirement Lump-Sum Distributions
by Purpose and Amount
(as Reported May 1983)

	Total	less than \$5,000	\$5,000 - \$9,999	\$10,000 - \$19,999	Over \$20,000
TOTAL RECIPIENTS ^a (000's)	6,594	5,533	583	218	154
Percent Distribution ^a	100.0%	84.2%	8.9%	3.3%	2.3%
ALL USES ^b	100.0%	100.0%	100.0%	100.0%	100.0%
<u>Total Saving</u>	<u>32.0%</u>	<u>26.0%</u>	<u>57.6%</u>	<u>78.9%</u>	<u>87.3%</u>
Retirement Program	4.4	2.4	*	*	*
Insurance Annuity	*	*	*	*	*
Housing Purchase	10.1	9.3	12.5	*	*
Other Investment	16.8	14.0	29.9	45.9	*
<u>Total Consumption</u>	<u>71.4%</u>	<u>76.6%</u>	<u>51.9%</u>	<u>42.6%</u>	*
Car Purchase	4.8	4.8	*	*	*
Vacation	3.2	3.1	*	*	*
Other Use	63.4	68.7	40.9	*	*

^a Recipients by lump sum amount are less than total recipients and percentages are less than 100 percent because of the omission of "don't know" and "no response" to the survey question on the value of the lump-sum distribution.

^b Percentages may add to over 100 percent because recipients may have used lump sum distribution in more than one way.

*

Number of workers too small for rates to be calculated reliably.

plans are reported to increase savings by at least 35 percent. The Congress must determine how important this capital formation is to the economy. It is clear from the data presented above that the system is producing significant retirement income in the presence of many plans that pay benefits in forms other than annuities.

If capital formation itself is not a sufficient goal to justify tax incentives, then capital gains and other preferences need to be reexamined as well. If this is the case, then retirement savings, as a narrower goal than under current law, would still merit tax preferences for employer plans if Social Security is to be maintained: both public support and economic well being are intertwined in this family of programs.

4f. How does this system of tax incentives for qualified pension plans as well as for increased savings through cash or deferred compensation plans and individual savings accounts fit in with current debate over basic tax reform?

The Administration argues in its proposal for tax reform that only retirement income merits tax incentives and that present rules should be modified to turn savings plans into retirement income plans. There is no comprehensive rationale put forward by the Administration in support of such a change in policy. Additionally, the Administration proposal maintains IRA limits at their current individual level, expands the spousal IRA, and reduces significantly what can go into cash and deferred arrangements through salary reduction. The argument appears to be that these programs are less efficient than employer-sponsored and funded plans where participation is mandatory.

Ideally, fundamental changes in tax incentives which have been the law since 1921 should not be changed without this Committee's careful review.